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## HOW GEORGE BUSH CAN HELP LECH WALESZA SUCCEED

### INTRODUCTION

Polish leader Lech Walesa arrives in the United States next week for what promises to be an emotional and triumphal tour. He will address a joint session of Congress on November 15, and will meet with George Bush. Walesa's visit comes at a dramatic time in Poland's history as that country is making bold strides toward democracy.

Poland's break with four decades of communist rule has come at dazzling speed. But Poland's democratic, non-communist regime now faces enormous, well-reported problems. The economy is nearing collapse; the democratic forces are weak and face a still-powerful communist party; and the Soviet Union can still intervene to halt democratization. No blueprint exists for transforming a communist country into a democracy and free enterprise economy because it has never before happened.

**Consolidating Democracy.** The emergence of a free and democratic Poland would transform the strategic map of Europe by undermining Soviet influence. Thus, the fate of democracy in Poland has enormous importance not only for that country, but also for the rest of Europe and for America. For this reason, the U.S. and its allies cannot passively watch events in Poland. Instead, they must act quickly and decisively to assist the democratic forces in consolidating their hold on power and enable them to sweep away the communists and escape from Soviet control.

Walesa's visit to the U.S. creates a compelling opportunity for the U.S. government to demonstrate its commitment to assist Poland's new democratic government. In his talks with Walesa, Bush should make clear America's strong support for the emergence of democracy in Poland, the recovery of its independence, and its transformation into a free market

economy. Bush then should tell Walesa that, to help build such a Poland, the U.S. is prepared to:

- ◆ ◆ Warn Moscow and the Polish communists against subverting the democratic forces in Poland.
- ◆ ◆ Use economic assistance to help Poland grow out of its economic difficulties, rather than to put it on the international dole.
- ◆ ◆ Press for Western debt relief, especially debt moratoria and write-downs by governments and debt-equity swaps by commercial banks.
- ◆ ◆ Ensure that economic aid to Poland goes solely to the private sector and does not favor those with political connections.
- ◆ ◆ Establish criteria for judging progress toward creating a free market as conditions for continued assistance.
- ◆ ◆ Remove all restrictions on Polish exports to the U.S.
- ◆ ◆ Establish management training and education programs to help the Poles prepare for the transition to a free market economy.
- ◆ ◆ Encourage the broadest possible range of ties between public and private organizations in the West and their Polish counterparts.
- ◆ ◆ Pursue innovative approaches to Poland's problems, such as the creation of a U.S.-Poland Development Fund to promote privatization of Poland's food distribution system.

## THE STAKES FOR THE WEST

The Free World has much to gain from Poland's joining the community of democratic nations. Not only would this be an affirmation of the West's fundamental values, but the expansion of democracy in the communist bloc contributes to the creation of a more peaceful world.

The West also would benefit economically from Poland's transformation into a free market economy. A productive Polish economy would be a source of valuable products for the West's consumers and a greatly expanded market for its exports.

Most important, the dramatic and unexpected events in Poland give the U.S. and the West an unprecedented post-World War II opportunity to transform the strategic situation in Europe. At little cost or risk, they can help the Poles win freedom and, in so doing, undermine Soviet influence throughout the continent. Soviet influence in Europe rests upon its military power, specifically its ability to pose a military threat to Western Europe. As virtually all Soviet lines of communications to its forces run through Poland, control over that country is a prerequisite for continued Soviet support of its East German satellite and the maintenance of its forces there.

**Obstacle to Invasion.** A stable democratic government in Poland threatens to undermine and eventually to break this connection by destroying the communists' internal political and economic base and eventually wresting

control of the country's destiny from the Soviet Union. By separating the Soviet Union from its East German satellite, a democratic and independent Poland would make a Soviet invasion of Western Europe extremely difficult. It would also make even the maintenance of its current force levels there increasingly problematic.

**Encouraging Opposition.** As the largest state in the region, a free and democratic Poland also would encourage the growth of opposition to communist regimes throughout the region, including inside the Soviet Union. Already, the Polish model encourages the democratic forces in the Baltic republics, Byelorussia, and the Ukraine.

For America, the most important issue is Poland's membership in the Warsaw Pact and Soviet control over the Polish military. At present, however, Poland's abrupt withdrawal from the Pact probably would be intolerable to Moscow. But a gradual withdrawal is possible, even likely. As its domestic power and stability increases, the democratic government inevitably will extend its control over Poland's police and armed forces. Once such control is established, other steps can follow, including requiring the removal of all Soviet troops, forbidding Warsaw Pact exercises on Polish territory, and an eventual withdrawal from the Pact's integrated military command. The end result would be the effective dismantling of the Pact, even if it remained formally in existence. Far from impossible, a similar series of steps has already been outlined for Hungary by the Speaker of its Parliament, Matyas Szuros.

## THE TRIUMPH OF DEMOCRACY

While the past year has been a time of rapid change in Poland, the Polish revolution has been a long time in the making. The Soviet-imposed communist regime's attempt to regiment society through decades of political repression and control of the economy never eradicated the hope of the Polish people for freedom and independence. The Catholic Church and peasants remained fiercely independent, while workers rose in revolt in 1956, 1970, 1976, and 1980. Then in August 1980, the Solidarity labor union was created and became increasingly powerful until the regime declared martial law on December 13, 1981. Solidarity was outlawed and its leadership imprisoned.

Meanwhile, the decline of the Polish economy, which had begun in the late 1970s, accelerated following the imposition of martial law. By late last year, one half-hearted economic reform after another having failed, the regime was forced to negotiate with the still-banned Solidarity.<sup>1</sup> The result was the historic agreement of April 5, 1989, in which Solidarity was re-legalized in return for its assistance in addressing the mounting economic crisis. Most

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1 On the economic reforms of the 1980s, see U.S. Department of State, *Economic Reform in Poland: Status and Prospects*, September 1989, pp. 7-9.

remarkable, however, was the regime's agreement to hold partially free elections for Poland's parliament.

Despite its attempts to rig the vote, the regime was totally defeated in the June 4th elections. Solidarity won every contested seat but one, while communists were rejected by voters even in those districts where communists ran unopposed. The communists' reserved quota of seats in the parliament eventually was filled only with Solidarity's cooperation, which it gave reluctantly to prevent the regime from renegeing on the entire agreement.

**Fragile Coalition.** With the communists' legitimacy destroyed and their confidence shattered, their position became untenable. As Janusz Ziolkowski, Chairman of the Foreign Affairs Committee of the Polish Senate, told a Heritage Foundation delegation visiting Warsaw last month, Solidarity's "moral victory" was total. Despite their great successes, however, Solidarity and its allies remain weak. Even with its overwhelming victory at the polls, Solidarity's agreement with the regime limits its representation in the parliament. Solidarity's assumption of power was possible only by the defection of the tiny Peasant and Democratic parties from the communist camp.

The result is the coalition government that includes some communists. The Prime Minister, Tadeusz Mazowiecki, and most of the economic ministries came from Solidarity ranks. Other positions are parcelled out to the Peasants and Democrats in return for their support. The ministries controlling the police and the military remain in communist hands to allay Moscow's suspicions of the new government's intentions toward the Warsaw Pact.

This coalition is precarious and destined to be short-lived. Defections by the Peasants and Democrats would rob the democratic forces of their working majority in parliament, and the communists have little interest in aiding the government's success. Once the democratic government becomes entrenched, however, new elections could be held which would be entirely free and in which every seat would be contested. This would sweep the remnants of the Communist Party out of the parliament, destroying its political power for as long as Poland remains a democracy. Only a coup or Soviet invasion could then reinstate them.

## OVERCOMING OBSTACLES

For the democratic government to accomplish its objectives, it must secure its power. In so doing, it faces enormous, some would say nearly impossible, tasks.

Only recently legalized, the democratic forces remain weak and inexperienced. Their control of parliament is limited and dependent upon the cooperation of elements of the old regime. Although greatly reduced in strength, the Polish United Workers' Party (Communist Party) remains powerful, controlling the police and military. Hundreds of thousands of Communist Party members remain in key positions throughout the

bureaucracy and society, able to sabotage government policies. Most ominously, the economic crisis that forced the communists to concede power to the democratic forces has worsened, and a free-fall into economic chaos is possible.

**Economic Ills.** Poland's collapsing economy comes as no surprise. It is the harvest of decades of institutionalized economic irrationality of the Stalinist economic system. Economic incentives were largely destroyed by the state's seizure of private property and the deadening hand of central planning. Private economic activity was either extremely limited or eliminated altogether. Much of the nation's resources were squandered on poorly-designed and ultimately uneconomic heavy industrial projects, such as the Lenin Steel Works at Nowa Huta. Agriculture and light industry, meanwhile were underfunded. The responsible positions in every enterprise and throughout the bureaucracy were staffed by the Communist Party members chosen for their political loyalty rather than their expertise.

Poland suffered from the ills common to all communist economies: declining rates of growth, technological stagnation, poor quality of products, wasted resources, lack of consumer goods, and distortion of incentives. Unable to correct these problems, the government borrowed billions of dollars from Western banks and governments in the 1970s. Instead of being invested productively, this money was wasted on projects of little merit.

**Deadly Circle.** The result is a foreign debt of approximately \$41 billion. Yearly payments on the interest alone would consume approximately 90 percent of Poland's export earnings. A far smaller percentage actually is paid, however, as the remainder is rolled over into the ever-increasing principal. Yet, even these limited interest payments have crippled Poland's ability to import machinery to modernize its antiquated industry and consumer goods to satisfy basic needs, including food. A deadly circle thus has been created where Poland's interest payments prevent it from importing what it needs to revive its export capacity, which in turn reduces its foreign exchange earnings and its ability to pay its debt.

Poland is also beset by hyperinflation. This year's inflation rate is expected to exceed 1000 percent, but could soar higher. The cause is as old as history: the regime has been printing reams of money to subsidize inefficient state enterprises, to boost wages artificially to keep peace with labor, and to cover the government deficit.

The burden of these and other problems falls squarely on the population. Already low, living standards are falling further. Basic consumer goods are becoming more scarce. The percentage of Poles below the subsistence-level official poverty line, already 40 percent of the population, is growing, sucking in ever larger segments of the professional classes, a bitter irony of Marx's prediction of capitalism's impoverishment of these same groups. In discussions with Heritage visitors in Warsaw last month, one Polish official went further, asserting that the economic situation of 80 percent of the population could be characterized as "bad" and getting worse.

Most worrisome is growing malnutrition. Food shortages already are a problem, and are sure to get worse in the traditionally difficult winter season. Prices on basic commodities have exploded. The price of meat has risen 1000 percent in two months; that of still subsidized bread and milk, 500 percent.

In brief, life may be becoming intolerable for a brave population which has suffered increasing economic misery for years. Polish officials and others with whom Heritage representatives met in Warsaw last month, including even the communists, agreed that the population supports the new government and is willing to endure significant hardships. Many expressed a fear, however, that food shortages and a general economic collapse could send people out into the streets and bring down the government. Minister of Construction Aleksander Paszynski told Heritage that the government had "three or four months maximum" to produce results.

## THE GOVERNMENT'S PLANS

To deal with this crisis, the new government led by Prime Minister Mazowiecki has unveiled a very ambitious plan designed to reverse the economic decline and also prepare the transition to a free market economy. The first priority of the government is to reduce inflation. By the beginning of next year, the government plans to slash the budget deficit, now 55 percent of total revenues or as much as 25 percent of gross national product in nominal terms, by cutting subsidies to unprofitable state enterprises and closing those which are hopelessly inefficient and unprofitable; limiting wage increases; tightening monetary policy and credit; and reducing government expenditures, especially for the police and military.

Then the government plans an enormously complex and difficult series of structural changes to build the foundations for a market economy.<sup>2</sup> This involves not only dismantling the old system through privatization of state enterprises and reduction of the enormous bureaucracy, but also creating the elements of a capitalist system largely from scratch. Among such elements: tax and commercial codes, a banking system, capital and labor markets, property rights guarantees, and corporate and business law.

**Dwarfing Thatcher's Task.** A private sector is to be created by removing restrictions on private economic activity and by selling or transferring state enterprises into private hands. Such privatization is an enormous task, as the state sector accounts for approximately 94 percent of industry. Currently, a variety of plans are being considered regarding how best to dispose of these assets, including employee buyouts, outright sale of enterprises to Poles and foreign investors, and even auctions. The emphasis is on disposing of them as rapidly as possible.

The scale and unfamiliarity of the planned changes are forbidding. The Polish task dwarfs, for example, Margaret Thatcher's privatization of only a

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2 "Poland makes a Dash for Economic Liberalisation," *Financial Times*, September 28, 1989, p. 3.

small part of the British economy, which has taken a decade to accomplish. And this was in a relatively prosperous and politically very stable country with a long heritage of free enterprise.

**Alien System.** Among the many problems is that few Poles have sufficient understanding of, or experience with, what is still the largely alien system of capitalism. There is a serious shortage of those with proficiency in accounting, business management, law, and finance, to name only a few of the most basic skills needed in business. In addition, there are few guidelines for transforming a communist economy into a free enterprise system. Never before has it been attempted for an entire economy.

Even in the best of circumstances, the deflationary policies and structural changes pushed by the Mazowiecki government would be expected to produce more economic hardship. The Minister of Social Policy, Jacek Kuron, told The Heritage Foundation that unemployment could reach 30 percent of the labor force as the reforms take effect. And Poland has only the rudiments of a social safety net to care for the unemployed and the poor.

Noticeable improvements in the economy will not occur until 1991 and probably only years later. It is an open question whether any government could survive such conditions, especially one that remains very weak and beset by powerful enemies who will work for its failure.

## U.S. INTERESTS IN A FREE AND DEMOCRATIC POLAND

Because Poland's transition to democracy is clearly in the interests of the West and the U.S., they should move quickly to reinforce the many trends toward democracy already underway. Although assistance, to some extent, should be a collective responsibility of the West as a whole, effective action requires America to lead, both by example and by taking the initiative in establishing a coordinated Western approach.

According to President Wojciech Jaruzelski's spokesman, Wladzimierz Lozinski, Poland's priorities for outside assistance are: 1) food and medical supplies to get through the winter; 2) credits for new materials and spare parts for industrial equipment purchased abroad; 3) fertilizers, pesticides, and herbicides to boost next year's agricultural harvest; and 4) foreign investment from the International Monetary Fund (IMF), World Bank, and other financial institutions, plus joint ventures with foreign firms, particularly in agriculture and food processing for the production of food exports.

The West already has taken some action to help Poland. At the behest of George Bush, who visited Poland last June, the European Community has devised an emergency aid package totaling \$325 million. This money is intended for emergency food aid, to stabilize the Polish economy, and for

management training.<sup>3</sup> Several West European countries individually have promised additional assistance, as has the European Investment Bank. The U.S. House of Representatives last month voted \$837 million of aid over three years, but the Senate has yet to vote on its own measure. The Polish government is talking with the IMF and the World Bank about loans for stabilizing Poland's economic situation and assisting the transition to a free market. The IMF is considering a \$1 billion loan, of which the U.S. share would be \$200 million.

### ***Political Assistance***

One of the West's most important, though least costly, influences is psychological. America can ensure that the government and people of Poland do not feel isolated as they struggle with the enormous problems confronting them. In the past, the West's seeming abandonment of Eastern Europe to Soviet domination was an important factor in demoralizing potential opponents of the communist regimes. This was true during the imposition of Soviet control after World War II and also for the Soviet invasions of Hungary in 1956 and Czechoslovakia in 1968.

America and its West European allies publicly should embrace the Mazowiecki government and welcome a democratic Poland into the West. During their Warsaw visit, Heritage Foundation representatives were told repeatedly by individuals from across the non-communist political spectrum, such as the leader of the Solidarity parliamentary group, Bronislaw Geremek, that one of the most effective ways for the U.S. to help Poland is continued high-level interest by American officials. This includes regular visits to Poland, public statements of support in Washington, and encouraging similar actions by the West European governments.

Genuine Polish political parties are emerging and in need of assistance, ranging from simple office equipment to instruction in the techniques of political polling. Ties between all levels of Western public and private institutions should be encouraged with their democratic counterparts in Poland to provide material assistance, expertise, and moral support. Example: the National Endowment for Democracy, the organization established by the Reagan Administration to promote democracy around the world, should increase its funding for Poland in general and provide technical assistance to these new parties in particular.

**Warning Moscow.** The West should make clear to Moscow that an attempt by it to suppress or turn back the gains made by Poland's democratic forces will impair seriously the West's relations with the Soviet Union. While the West cannot prevent the Soviets from trying to reimpose control either through invasion or through a communist-led imposition of martial law should Moscow decide to do so, it can raise the potential costs to the Soviet Union of such action. This may deter it.

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<sup>3</sup> The U.S. and Poland signed a scientific and technical exchange agreement in September 1987 to improve cooperation in these areas. The U.S. has provided \$600,000 for this program.



Several Poles, including officials and others in the democratic movement, expressed to The Heritage Foundation in Warsaw last month their belief that Moscow's willingness to tolerate the changes taking place in Poland and Eastern Europe is connected with its desire for expanded economic contact with the West. Given this leverage, a coordinated Western position that made clear the negative consequences for economic relations in the event of a crackdown could provide extra protection for the democratic forces in Poland and throughout Eastern Europe.

The same message should be sent to those in the Polish Communist Party who may attempt to seize power. Perhaps the most powerful message of this kind would be a declaration that all Western assistance to Poland would halt in the event of a coup. Faced with the prospect of having to address a deteriorating economic situation, which they already have demonstrated an inability to resolve, Poland's communists may be deterred by a firm Western stand. Effective pressure would require a united Western stance which only U.S. leadership can provide.

### ***Economic Assistance***

Western economic assistance will play a critical role in Poland's recovery. Without such help, the chances of the Mazowiecki government successfully addressing Poland's economic problems are minimal.

Potential Western assistance falls into two categories. The first, and most important, is immediate support to enable the new government simply to survive. Second, and less pressing though very critical, are longer-term programs aimed at easing the transition to a free market economy. For if the democratic government survives, Poland's long-term economic future is bright; if it fails, longer-term assistance will be irrelevant. As Jerzy Nowak, Director of Planning at the Foreign Ministry put it to visiting Heritage Foundation representatives, "If this government can survive one year, everything else becomes possible."

The case for Western assistance to Poland is obscured by a confusion of these two types of assistance. Mindful of Poland's squandering of billions in Western loans in the 1970s, many in the West understandably either oppose substantial aid outright or demand a series of stringent litmus tests relating to economic reform, specifically a restructuring and privatization of the economy, before any substantial new aid is granted.

**Inappropriate Pressure.** While the concerns raised are valid, they may be less relevant in the rapidly changing conditions of Poland. The assumption that pressure is needed to induce the Polish government to adopt necessary reforms was correct when the communists were in power. Pressure may be inappropriate now, with a democratic government that already is planning a rapid restructuring of the economy and its transformation into a free market. A wide range of Polish officials responsible for the economy, such as Minister of Foreign Trade Marcin Swiecicki, acknowledged to The Heritage Foundation that the growth of the private sector and the attraction of

much-needed foreign investment would depend largely on the government's effectiveness in implementing these reforms.

**Urgent Needs.** Immediate assistance from the U.S. should be directed at relieving the enormous pressures on the government. Food assistance is a high priority. So are medical supplies. It would be a mistake, however, for Western nations to dump surplus food into Poland. As has happened in scores of Third World countries, this simply would prolong the food crisis by depressing food prices and thus incentives for farmers to produce more. Even more important than food supplies are farm machinery and agricultural chemicals such as insecticides, herbicides, and fertilizers. The communist Deputy Minister of Agriculture, Wieslaw Mlynarczyk, emphasized to Heritage visitors last month that the need for such products exceeded even that for food this winter.

One of Poland's greatest needs is the hard currency to buy the raw materials, new machinery, spare parts, and other industrial goods to revive the economy. Hard currency is also required to stabilize Poland's monetary system and to import many basic consumer goods. Poland already earns hard currency through such exports as coal and other raw materials such as copper, as well as textiles and semi-processed industrial goods. This year, Polish exports are expected to total \$8 billion.

### ***Debt Relief***

Approximately 25 percent of Poland's export earnings are absorbed by interest payments on Poland's \$41 billion hard-currency debt. Even this payment, however, represents only one-quarter of the actual interest due, with little or no payment on the principal. Rather than provide new loans, which add to the debt, America should devise a policy of debt relief to allow Poland to use the hard currency it earns to tackle its own priorities.

A debt relief package could include: 1) a moratorium on payments of interest and principal; 2) debt writedowns; and 3) debt-equity swaps.

While deferring interest payments through a moratorium would help in the short-term, it increases the long-term burden by adding debt to the principal.

Debt writedowns, by contrast, provide immediate and long-term assistance. The actual new costs to Western governments and financial institutions in writing down the Polish debt, in fact, would be considerably less than the size of the debt suggests. Because the international financial market already has concluded that much of Poland's debt is unlikely ever to be repaid, Polish notes are trading in Western financial markets at around 33 percent of book value. West Europeans loaned great sums to Poland during the 1970s, despite strong U.S. warnings. Washington should urge these governments to admit their mistake and help Poland by writing down the outstanding debt. Washington should take the lead by doing so itself. Poland now owes the U.S. government \$2.2 billion and West European governments more than \$25 billion, at face value.

The U.S. government, meanwhile, should urge American and other Western commercial lenders to consider debt-equity swaps with Poland. In a debt-equity swap, the lender (such as a West German bank) sells its hard currency debt at a discount to a middleman. The middleman then redeems the debt from the debtor country's government for local currency or some state-owned asset, such as shares in a factory. The lender thereby recovers part of a loan that likely never would be repaid in full, the middleman becomes an investor in the local economy, and the debtor government's external debt is reduced. A number of indebted Third World countries, like Chile, are using debt-equity swaps in this way.

In Poland's case, the state owns a wide range of enterprises, from tourist resorts to steel factories, that could be transferred to Western investors in return for an agreed-upon reduction in Poland's debt. Polish Minister of Foreign Trade Swiecicki told visiting members of The Heritage Foundation last month that "The Polish government is ready to have debt-equity swaps." The fire-sale prices of Polish assets, moreover, are an attractive alternative to near-worthless loans.<sup>4</sup>

### ***Earning Hard Currency***

The West can also help Poland grow out of its dismal economic situation by opening markets to Polish exports. Export-led growth would stimulate Polish industry as well as provide needed hard currency. The U.S. already has taken important steps to reduce its restrictions on imports from Poland, such as restoring Most-Favored-Nation status, suspended after martial law, and allowing Polish exports to enter the U.S. under the Generalized System of Preferences, normally given only to developing countries. Jan Padlewski, Director of the Department of Economics at the Foreign Ministry, identified quotas on textiles and steel as the most important remaining restrictions for the U.S. market. Padlewski told Heritage Foundation visitors that Poland is capable of exporting more wool products to the U.S. than allowed by U.S. quotas. These restrictions on Polish exports should be removed entirely.

An additional way of boosting Poland's hard currency earnings would be to create a guest worker program in which Poles would work in the West and be allowed to send home portions of their hard currency wages. A single worker in the West can often support an extended family in Poland on a relatively small salary. At the current free market exchange rate in Poland, \$1 buys the equivalent in zlotys of an average daily wage.

The U.S. then should increase its management training assistance to Poland to provide needed expertise in the workings of a free market economy. Minister for Foreign Trade Swiecicki told The Heritage Foundation that the problem of a lack of expertise extended into every area of the economy and was a major impediment to reform. Training centers could be established in Poland and staffed by Western economic and business

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<sup>4</sup> See also Melanie S. Tammen, "Reducing Third World Debt: Private vs. Public Strategies," Heritage Foundation *Background* No. 699, April 10, 1989.

experts teaching entry-level, mid-career, and senior-level courses in business management and free market economics. These should be established in cooperation with Western universities and management training businesses with the U.S. government helping to subsidize the hard currency expenses involved. This program also should help create and expand the economics and business faculties at Polish universities, and offer scholarships for Polish students and faculty to study in the U.S. in these disciplines and to serve as interns at banks and stock exchanges. The U.S. also should insist that a small portion of the cancelled Polish debt be used to fund these training enterprises and to translate business and management textbooks into Polish.

The West also should challenge Moscow to assist Poland. The present economic mess is a direct result, in great part, of Soviet plundering of the country after World War II, such as its dismantling and transporting entire factories to the Soviet Union, and the imposition of the Stalinist economic system, the ruinous effects of which have been admitted even in the Soviet Union. At a minimum, the Soviets could begin with forgiving Poland's \$3 billion hard currency debt to them.

## **CRITERIA FOR LONGER TERM ASSISTANCE**

The U.S. assistance program for Poland unveiled by George Bush during his June visit to Warsaw, as well as the plans proposed by Congress, center around the creation of a so-called enterprise fund. With this fund, the U.S. would lend capital to private businesses in Poland. To administer this fund, a board of directors, composed of Americans and Poles, would be established.

This enterprise fund is a good idea. It will fail, however, unless the Polish government enacts reforms to enable a free market to function effectively. Although the Polish government is committed to creating a free enterprise economy, its efforts may be undermined by the scale and complexity of the task and the unfamiliarity with the workings of the capitalist system. There may also be a strong incentive to delay necessary changes because of their painful short-term effects. To help prevent this, the U.S. should establish criteria to serve as benchmarks by which both Warsaw and Washington could judge the Polish government's progress toward establishing a free market economy. The criteria also would allow the U.S. to determine if its aid to Poland is being used wisely. Such criteria should include:

### **1) Guaranteeing Security of Property and Contract.**

Polish citizens should have the right to acquire and dispose of private property in all its forms, including secure legal title. Property rights can be protected only by an independent judicial system with the power to enforce contracts for individuals against the government.

### **2) Eliminating Obstacles to Entrepreneurial Activity.**

The private sector should be deregulated broadly and competition promoted. Monopolies in the state and private sectors can be countered best by permitting unhindered entry to, and exit from, the market by new

enterprises. Currently, a cumbersome system of registration and approvals is necessary to create or expand a private business. Government red tape can delay the start-up of a new business by months. State enterprises are given privileged access to credit and scarce supplies. And the state distribution and retail network has not yet been replaced by the private sector.

### **3) Ending Wage and Price Controls.**

Government controls over wages and prices should be abolished and market forces allowed to operate freely. Inflation can only be controlled through a balanced budget.

### **4) Reforming the Tax System.**

The Polish government should restructure its tax system to promote incentives in the private sector and the formation of private capital. The present 50 percent tax on profits discourages private businesses. This tax already is too high, yet the government plans to raise taxes on the private sector to balance the state budget. While reducing the deficit is of critical importance, raising taxes threatens to hobble the fledgling private sector on which Poland's future depends. A much better alternative to raising taxes would be reductions in spending and the sale of state-owned enterprises. Specifically, the profit tax rate should be reduced to no more than 30 percent. The government also should avoid attempting to attract foreign capital through a preferential rate of taxation. Such an approach discriminates against domestic capital and cannot compensate for the absence of attractive business opportunities. There will be no need to bribe foreign investors if the proper economic climate is established.

### **5) Removing Barriers to Foreign Trade.**

Polish individuals and private enterprises should be allowed to operate directly in the international market; they should be able to import and export without the current government intermediaries. The government should eliminate restrictions on the availability of foreign exchange, and remove market-distorting export incentives such as subsidies. Foreign exchange rates should be determined by the market, rather than by government edict. Foreign investment should be encouraged and allowed to operate in Poland on equal terms with Polish businesses.

### **6) Ending Restrictions on Investment and Capital Flows.**

Polish and foreign citizens should be able to invest freely and on an equal basis in the Polish economy and to dispose of financial and other assets without government interference. The entry and export of capital to and from Poland should be unrestricted. The state banking system should be replaced with a number of private commercial banks empowered to operate in all areas of the economy. These should include Polish and foreign banks, and competition among them should be encouraged as well.

### **7) Privatizing the State Sector.**

Over 90 percent of Polish industry is state owned. All state enterprises should be candidates for privatization, from the state fishing fleet to coal mines. They can be privatized through outright sale or leasing of enterprises, whole or in part; by auctioning them; or through employee buyouts. Care should be taken to ensure that the transfer of state assets to the private sector not be influenced by political considerations nor biased in favor of individuals or groups with privileged connections to the government or the previous regime. Foreigners should be allowed to purchase or lease these assets on equal terms with Poles.

## **DARING A BOLD STRATEGY: U.S.-POLAND DEVELOPMENT FUND**

The U.S. government's plan to provide Poland with substantial amounts of aid, including shipments of surplus food stocks, offers a unique opportunity to encourage Poland to make some of the necessary market reforms in its system. Using the needed food shipments as a lever, a bold, comprehensive plan could be developed that offered the beginning of a solution to Poland's problem of immediate food shortages as well as the problems of foreign debt, inefficient state-owned enterprises, a moribund farm sector, limited financial institutions, and inflation caused by too many zlotys in circulation. The focal point of the program would be the requirement that all U.S. food aid must be distributed and utilized by private sector entities in Poland. The purpose is to encourage the Poles to swiftly privatize their inefficient and costly food distribution system, and to provide the needed price incentives to the farmers.

To facilitate the transfer, a joint U.S.-Poland Development Fund could be established in Warsaw, funded by debt-equity swaps, which may include the \$2.2 billion that Poland owes the U.S. government. As an example, the U.S. could convert some of this debt into an equity stake, measured in zlotys, in a newly-created Development Fund jointly owned by the U.S. and Poland. The Fund would then acquire, at a concessional price from the Polish government, all state-owned food distributors, wholesalers, storage facilities, bakeries, mills, food retail outlets, and the other parts of the food processing and distribution system.

The Fund would immediately privatize these business establishments by selling them, in well-defined units, to the workers in these enterprises, or other interested domestic investors and entrepreneurs, accepting zlotys, which are overabundant, as a down payment or partial payment for the businesses. Debt could be taken back by the Fund to pay for the remainder of the cost of the enterprises. Some portion of the zlotys paid the Polish government by the Fund for the food enterprises, as well as those paid the fund by the worker/owners, could be taken out of circulation.

**Reducing Inflation.** Such a series of transactions have the added advantage of pulling some of the abundant supply of zlotys out of the system, thereby diminishing the severe inflationary pressures which now confront Poland.

Most people have plenty of zlotys but nothing to buy with them. By taking zlotys out of circulation inflation would be eased. As part of the return for their down payment, the new privately-owned food enterprises would be entitled to purchase from the fund, for zlotys, wheat or flour from the U.S. This would get the food supplies to those who can use or distribute them the best and create an efficient and competitive food distribution network that will ease food shortages by the next harvest. Some portion of the zlotys earned by the fund through sales of grain and other food stocks could also be retired while others could be used by the Fund to make loans to facilitate further privatization and small business development. There is plenty of precedent for such an arrangement. In many cases in other developing countries, under the so-called P.L. 480 program, the United States Agency for International Development (AID) "sells" surplus food stocks to domestic suppliers for local currency. In turn, the AID mission in that country uses the local currency to help fund privatization and business development programs.

The emergency food sales would be a one-time event for the purchasing enterprises. The food aid would be "sold" over the next three or four months to help the Poles through the winter but assure that prices for farmers would not be depressed into the next growing and harvesting season. Beyond serving as an efficient distribution system for the U.S. aid, these newly-created food enterprises, now in the hands of private owners and owner/workers, would have the incentive to seek new supplies of wheat or flour from the Polish farmers at competitive prices that encourage the farmers to produce at much higher levels. If necessary, the Fund could lend the zlotys back to the enterprises for capital improvements or even for down payments on contracts for future wheat deliveries.

**Encouraging Rapid Movement.** The owners of the new enterprises would gain experience in the essential aspects of business in a market system, create the beginnings of a commercial finance system, and spur entrepreneurial initiative throughout the system. This approach could take place very quickly. Some delays could be expected as workers secure zlotys for the down payments on their enterprises and as bureaucratic obstacles delay the transfer of titles to workers. However, a U.S. policy of "no privatization, no food" should encourage the government to move rapidly.

Needed zlotys could come from the workers' own savings and by borrowing from friends and family. The two governments could be required to divest themselves of their shares in the Development Fund by selling them to domestic or foreign investors once a stock market emerges, thereby extracting the governments from the market and leaving Poland with a major commercial venture that is privately owned.

When presented with this plan last month by Heritage representatives, Minister of Foreign Trade Marcin Swiecicki said that it was "fantastic" and urged that the U.S. government present it as an official proposal to the Polish finance ministry

## CONCLUSION

Through great danger and sacrifice, inspired by the values of the West, the Polish people are breaking free from over four decades of Soviet rule and are reestablishing their connections to the Free World. In so doing, they have presented the U.S. and its Western allies with an opportunity to undermine the foundations of Soviet control over Eastern Europe and its ability to threaten the West.

In its efforts to aid Poland's struggle, the U.S. must be careful not to promise more than it can deliver. The victory of the democratic forces in Poland and the revival of the Polish economy can only be secured through the efforts of the Poles themselves. At best, the U.S. and the West can ease some of the pressures and remove some of the obstacles.

**Bolstering Poles' Spirit.** The U.S., however, can play an important role in restraining Soviet intervention or a communist coup by warning of the consequences on their relations with the West. And it can bolster the Poles' spirit to face the tasks before them by proclaiming strong and continuing U.S. support for their struggle.

U.S. and Western assistance should be aimed at helping Poland grow out of its economic difficulties through the use of its own resources. The U.S. and the West can help to free these resources through debt relief and other programs aimed at increasing Poland's ability to earn hard currency.

**Creative Approaches.** The admirable determination to help Poland overcome its economic problems should not blind the U.S. and the West to the long-term damage that is done by traditional approaches to providing assistance. U.S. and Western aid must be carefully designed to avoid exacerbating Poland's problems, as providing surplus food is likely to do. Creative approaches are needed because Poland's emergence from communism presents unique problems. One such approach would be the proposal to use Poland's debt to the U.S. government to restructure Poland's food supply system and provide a lasting benefit to the Polish people beyond short-term charity.

George Bush should use Lech Walesa's visit to reaffirm the U.S. commitment to Poland, to outline the goals of U.S. assistance, and to press upon him the need for rapid action on the economic reforms. His message must be that the U.S. and the West stand with Poland during the hopeful and difficult time of its democratic and economic rebirth.

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