

January 1990

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### Recommended Citation

Soltysinski, Stanislaw (1990) "Legal and Structural Aspects of Privatization in Poland," *Florida Journal of International Law*: Vol. 5: Iss. 2, Article 6.

Available at: <https://scholarship.law.ufl.edu/fjil/vol5/iss2/6>

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## LEGAL AND STRUCTURAL ASPECTS OF PRIVATIZATION IN POLAND

*Stanislaw Soltysinski\**

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### I. INTRODUCTION

Although neither the Polish Government coalition nor the Solidarity-led opposition groups have decided yet how far they would support privatization schemes, both alliances are in favor of equal treatment of all sectors of the economy and accept the proposition that a meaningful market reform will entail substantial privatization.<sup>1</sup> Perhaps the most surprising aspect of the present situation in Poland is that it is unclear whose supporters, those of the Government coalition or those of the Solidarity alliance, are more enthusiastic about privatization.<sup>2</sup> However, recent public opinion polls indicate that public support for privatization has been steadily growing during the last decade.<sup>3</sup> Meanwhile, perhaps the most controversial aspect of the present debate is how to transform the present, basically State-owned economy, into a mixed-economy. The procedure of transformation requires the adoption of new legal solutions. Yet public attitudes toward law as an

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1. See, *The Reports from the Round Table Negotiations*, *Zycie Gospodarcze*, Apr. 16, 1989, at 7 [hereinafter Round Table documents]; see also *The Election Program of Solidarity*, *Tygodnik Powszechny*, May 7, 1989, at 1.

2. The same is true about the leaders of the two coalitions. "At the economic table the divisions ran almost as much within the two delegations as between them, with . . . social democrats on both sides and neoliberals on both sides." Ash, *Revolution: The Springtime of Two Nations*, N.Y. REV. OF BOOKS, June 15, 1989, at 3.

3. Compare Cf. Prof. M. Guzek's paper presented during this conference.

instrument of change range from assumptions that its role will be minimal in a market economy system to the proposition that privatization and the creation of a financial market can be achieved immediately by way of a super decree promulgated by a coalition government. These two extreme views are shared by some economists.<sup>4</sup>

A more realistic proposition seems to be that the role of law will be increased in the future and an in-depth knowledge of modern corporation law, commercial law, and securities law is a prerequisite for successful implementation of the reform. Although the government's power to directly control the economy will be drastically limited, its involvement in business will remain.<sup>5</sup>

This article focuses on legal aspects of the present privatization schemes such as transformation of State-owned enterprises into mixed companies with the participation of their employees and other shareholders. In addition, it discusses briefly other forms of indirect privatization or "genuine socialization"<sup>6</sup> of State property such as leasing state enterprises by management or employees.

Structural aspects of privatization analyzed in this article include relations between the management and the Employee Council (ECs), the institutional control of the process of denationalization, and the future role of foreign investors in the securities market.

## II. PROPOSALS CONCERNING DENATIONALIZATION SCHEMES

The great majority of Polish economists and lawyers agree that privatization should entail a gradual process of transformation of State-owned firms and cooperatives into private corporations, partnerships and "genuine" cooperatives. Many authors favor various forms of mixed-companies with participation of the State Treasury as a majority or minority shareholder.

The barriers constraining the pace and scope of denationalization schemes are financial, political, psychological and structural ones.

4. Such a plan was proposed by Krawczyk, *Skrypt do Kapitału*, PRZEGLĄD TYGODNIOWY No. 49 (1988). *Contra* Soltysinski, *Uwłaszczyc emerytów*, PRZEGLĄD TYGODNIOWY No. 3 (1989); Polaczek, *Nieporozumienie*, PRZEGLĄD TYGODNIOWY No. 3 (1989).

5. "Virtually every major department of the typical corporation in the United States has one or more counterpart in a government agency that controls or strongly influences its internal decisionmaking." M. Weidenbau, *Regulation: A Different Approach*, 3 DIALOGUE 25 (1981).

6. The term "genuine socialization" (rzeczywiste uspołecznienie) is often used in Solidarity documents. It usually denotes the process of transformation of a State-owned enterprise into an employee share company, or a State-owned corporation co-managed by the employee council. See *The Election Program of Solidarity*, *supra* note 1.

First, according to various economic estimates, the total value of private investment capital in Poland represents between seven and ten percent of the officially declared value of the State-owned assets. Second, because of slightly different political considerations neither the government nor the Solidarity alliance is likely to support an idea of a radical and comprehensive privatization. Third, deep denationalization schemes do not enjoy enough support among various groups of the Polish electorate such as unskilled labor, older employees, party conservatives, partisans of the employees' participation in management movement, and some trade-unionists, especially the so-called "neo"-trade unions. Finally, a total denationalization could lead to massive unemployment and bankruptcy of many firms which are now assigned with special tasks either in the field of essential public services or foreign trade, especially those involved in intra-COMECON (Council on Mutual Economic Assistance) trade. Additionally, social security and traditional sources of supply of basic raw materials could be suddenly called into question.

Proposals advocating immediate and nearly total privatization aimed at transforming State-owned enterprises, banks and even the social security system into privately-owned corporations are also rejected by many neo-conservative and neo-liberal economists.<sup>7</sup> Radicals, whether Jacobins or Bolsheviks, have much in common. They tend to introduce their sweeping social experiments by way of uniform decrees without paying attention to social costs. They try to "liberate" citizens even against their will and do not pay attention to details or procedures.

Similarly, proposals calling for immediate and massive "enfranchisement" of employees of State-owned enterprises, beneficiaries of the social security system, and owners of bank savings by way of a legislative<sup>8</sup> fiat not only disregard public attitudes and choices but are inconsistent with free-market economy principles. Neither employees of inefficient State enterprises nor owners of savings deposits would be willing to become shareholders whereby they would be burdened with liabilities of unprofitable companies or debt-ridden banks. A Denationalization Decree granting employees shares in their companies "free-of-charge" would amount to a super-rationing scheme. Rationing of food seems to be a simpler task than "just" apportionment of corporate shares among twelve million State employees along with mil-

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7. Cf. Mozolowski, *Kto kupi Nowa Hute*, *Polityka*, May 13, 1989, at 4 (a report from an economic seminar on privatization sponsored by The Catholic University, Lublin in 1989).

8. Such proposals are advocated by Krawczyk, *supra* note 4.

lions of depositors and beneficiaries of the social security system. Also, free "enfranchisement" at no cost to the employee-shareholder would send a false signal to the emerging financial market. An opportunity for lowering the State Treasury's deficit would be missed and so would the chance of transforming the mentality of employees. Only an employee who invests and risks his own capital is likely to treat the company as his own business. By contrast, many shareholder-donees would dispose of their shares well below their fair market value. Rampant speculation could bring about new crises and discredit "free-market" policies. Finally, total and immediate denationalization is not feasible because of organizational and structural considerations.

The relevant stipulations of the Round Table Agreement also relate to socio-economic policies and structural reforms. All parties have agreed that the new economic order should be based upon the principle of "freely formed ownership structure."<sup>9</sup> It also has been agreed that the Constitution should guarantee durability of pluralistic ownership of the national economy and that the State agencies supervising public, State-owned, companies should be substituted for one agency called The Fund of National Assets.<sup>10</sup> The management of the Fund is to be appointed by the Parliament.

The Round Table Agreements provide that regulations concerning denationalization should be promulgated by the Parliament. The documents contemplate the following patterns of direct or indirect denationalization: 1) sale of a State-owned enterprise; 2) sale of the majority of shares of a State-owned enterprise to a private investor; 3) transformation of State-owned enterprises into employee stock-ownership corporations (ESOCs); and 4) leasing State-owned enterprises to employees or other investors.

The existing system of joint-ventures with the participation of foreign capital constitutes yet another form of denationalization. Assets invested by a State-enterprise in such mixed companies are no longer all national or State property.

The parties to the Round Table Agreements seem to support the idea of ESOCs. They call for establishing a legal framework for transforming State-owned enterprises into companies owned by employees and other persons. Additionally, the document stresses that conveyance of a State-owned company to a lessee in consideration of rent should be preceded by competitive bidding.<sup>11</sup>

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9. *Round Table Documents, supra* note 1.

10. The Polish translation of the Fund of National Assets is Fundusz Majatku Narodowego.

11. The Polish translation of competitive bidding is *Przetarg*.

It is clear that the signatories of the Round Table Agreements opted for a gradual and partial privatization scheme subject to public control. Stipulations on acquisition of State assets by private investors assume that such transactions are subject to consideration. Free "enfranchisement" of employees is neither mentioned in the Agreements nor in the Party or the Solidarity election programs.

While the political resolutions discussed above do not prejudice the scope of privatization, there are statements suggesting that State ownership will remain the dominant form of property. For example, the employees' self-government is listed as the first principle of the new economic order. The idea of joint-management and participation on the scale contemplated by the text of the Round Table resolutions is difficult to reconcile with the traditional private property approach. The documents provide for granting unprecedented powers to ECs. At the enterprise level these powers will include the board of directors' appointment of top management, fixing its salary and the terms of its employment contract, distributing after-tax profits of the company, and approving in advance major business decisions such as long term contracts and dispositions of certain types of assets.

Polish ECs combine broad powers of supervision over management with the right of co-management in areas specified by statute. In addition, the ECs are expected to obtain a statutory right to set up an all-Poland Assembly of Employees Councils, an official lobbying platform empowered to present its proposals and recommendations to the Executive and the Parliament, as well as to all review legislative proposals concerning economic policies and structural changes in the national economy.

Since such a broad scheme of employee self-government has never been implemented in any developed or semi-developed country, with the possible exception of Yugoslavia, some economists and lawyers have begun to voice objections. They argue that the Yugoslav experiment has largely failed. Furthermore, allowing employees to control management and directly participate in operating their company does not contribute to operational efficiency and long-term maximization of profits. Managers free from government control may be muzzled by local structures of ECs. Experience shows that members of an EC, elected and responsible to their fellow employees, often act as trade-unionists or as political activists. Therefore, in many cases ECs cannot objectively evaluate the employer's economic decisions. In the context of the evolving new economic system, the idea of strengthening ECs powers is becoming questionable even to those who supported it in the past as an instrument of shielding a company's management against the exercise of government control.

Since ECs tend to act as employees' agents, the idea is not assessed favorably by managers both in State-owned and private companies. However, because only the private sector is independent enough to voice its resistance, the Round Table documents state that future legislation should establish employees' participation in private firms with more than a hundred employees, while in joint-ventures with foreign capital this scheme would be voluntary.

The future statutory powers of local ECs, and their national Assembly will directly influence the pace and scope of privatization. The Round Table resolutions call for promulgating statutory guidelines concerning sales of State enterprises and their assets to private investors. In the event of transformation of such an enterprise into a corporation or employee-share corporation, and in case of leasing to a private lessee, the plan must be approved in advance by the proper EC. The final and binding decision of the local EC shall be preceded by a referendum among the employees and approved by the authorities of the Fund of National Assets. However, the results of the referendum are not conclusive. An EC has the power to veto a plan of privatization approved by their employees, the management, and the Fund.

The partisans of the employee self-government approach also have succeeded in obligating the signatories of the Round Table to agree that ECs should have effective control over activities of those representatives of their enterprises who are appointed as directors and officers in their controlled companies, totally or partially owned by the parent State-owned enterprise. The resolutions further provide that the bill should be elaborated with the participation of ECs representatives and presented to the Parliament before the end of this year. The sweeping language of that text implies that the proposed regulatory scheme is aimed at giving ECs in State-owned enterprises an effective, albeit indirect, control over management of all public stock and close corporations.<sup>12</sup> Thus, management of State enterprises will be prevented from mitigating the burdens of the Statute on Employee Councils of 1981<sup>13</sup> by setting up subsidiaries in the form of share corporations to which this law does not apply. The new law also indirectly will affect joint-ventures with the participation of State enterprises and foreign capital.

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12. For example, this would appear to be applicable to limited liability companies partially or totally controlled by a parent State firm.

13. Ustawa z 25 wrzesnia 1981 o samorzadzie zalogi przedsiebiorstwa panstwowego 1981 Dziennik Ustaw [Dz. U.] No. 24, item 123.

The consequences of such an idea are somewhat drastic. It would mean, for instance, that an officer of a joint-venture formed by a domestic State enterprise and a foreign corporation would be controlled not only by the board of directors of the subsidiary and by the management of his former employer but also would be accountable to the EC of the Polish partner even if the latter is a minority shareholder. In a market economy system and in all company laws, a corporate executive is an employee or agent of the owners of the business.

Although the basic understandings concerning the establishment of legislative guidelines for disposition of State assets are timely and sound, the agreed sales or lease of enterprises procedure seems to give too much discretionary powers to ECs. That process should be designed to ensure the best use and management of the public assets, not to maximize the leverage of a particular EC. Even the interests of the employees of the enterprise concerned should yield to the overriding public interest. Such conflicts of public and group interests come into play when a proposed sale or lease would result in major lay-offs or dissolution of a local EC. Therefore, the whole procedure should be reversed. The employees ought to be consulted on a sale proposal or lease of a State enterprise through a referendum or with their EC and then decided by the Fund of National Assets. The decision could be subject to judicial review to limit the discretion of the agency and make its actions responsive to legislative guidelines. The EC concerned should be able to challenge final administrative decisions concerning the disposition of their enterprise, but the ultimate resolution of a dispute whether a proposed sale or lease is in the public interest ought to be deferred to an independent administrative agency established by the Parliament subject to narrowly defined judicial review.

The present consensus among the signatories of the Round Table negotiations requires unanimity among the Fund authorities, a prospective buyer of State assets, an EC concerned and, possibly, the employees of a disposable enterprise. This unanimity combined with the discretionary veto power of the EC resembles the infamous LIBERUM VETO, the right of each member of the old Polish Diet to reject its legislation against the will of the overwhelming majority.

For reasons of economic efficiency, fairness, and predictability, the new Parliament should promulgate guidelines and procedures aimed at striking a balance between conflicting interests of all persons and groups affected by individual privatization decisions.

### III. THE EXPERIENCE AND LEGACY OF THE EXPERIMENTS IN PRIVATIZATION OF STATE-OWNED ENTERPRISES

Two distinct but interrelated arguments are being advanced against the first experiments in denationalization of State assets. First, conser-

vative elements in the Party argue that such decisions led to "selling out" socialist principles. Furthermore, they maintain that privatization schemes are illegal under the Constitution which provides for the retention and strengthening of State ownership of basic means of production. Second, many opposition experts, especially those associated with the EC movement, question the Executive's authority to approve privatization transactions on legal and political grounds. In their opinion, the present experiments are conducted without public participation and legislative authority.<sup>14</sup> Indeed, neither the Law on State Enterprises of 1981<sup>15</sup> nor any other statute gives the Executive explicit authority to sell or lease a State enterprise. The government relies upon a controversial Statute on Extraordinary Competencies and Powers for the Council of Ministers in the Management of the National Economy<sup>16</sup> and other extraordinary mandates which are due to expire by the end of this year. This law gives the Executive the authority to wind up State enterprises and introduce management experiments.

The four privatization cases described below exemplify legal and policy problems arising in this field. On December 31, 1988, the Prime Minister signed a decision dissolving OMIG, a medium-size State-owned enterprise, the way for the first major experiment in denationalization. Dissolution was necessary to experiment in leasing all assets of OMIG to its managing director. The Prime Minister's decision was preceded by a referendum held among OMIG's employees during which 70 percent of the work force approved the director's plan. The scheme was also supported by OMIG's EC. The council passed a resolution to terminate its own existence as an organ of the enterprise. The long-term contract, whereby a limited liability company, incorporated by the former director, acquired interests in the assets of the dissolved enterprise, can be characterized as a "contractus in-nominatus" having the combined characteristics of leases and loans.

OMIG's fixed and capital assets are subject to a usufructuary lease whereas its remaining property, inventory, is borrowed by the lessee. The latter is obliged to pay the lessor, the Treasury, a special dividend

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14. See Bratkowski, *Odnova*, *Gazeta Bankowa*, May 29, 1989.

15. 1987 Dz. U. No. 35, item 201. However, in 1989 an amendment was introduced which provides that a State enterprise can be transformed into a share corporation at the request of its management and its EC, supported by a majority of the company's crew. Finally, such a motion shall be approved by the founding agency. 1989 Dz. U. No. 10, item 57.

16. 1988 Dz. U. No. 13, item 98. Art. 1(2) empowers the Council of Ministers to dissolve a State-owned enterprise to improve the efficiency of the economy. These powers have been prolonged and expanded by the Statute on Conditions of Consolidation of the National Economy of Feb. 24, 1989, 1989 Dz. U. No. 10, item 57.

which is 10 percent higher than that imposed upon State-enterprises. Additional conditions attached to the conveyance include the lessee's duty to produce goods ordered by the lessor. Only new equipment acquired by the lessee is not subject to such a burden and can be exploited freely by the owner.

Another denationalization plan was elaborated by the management and employees of DANDYS, a medium-size textile enterprise from Lodz. The proposal calls for leasing the assets of this municipal enterprise to a limited liability company owned exclusively by DANDYS' employees. The EC and more than 85 percent of the work force approved the plan. However, the supervising organ, the President of the City of Lodz, has not decided yet whether or not to accept the offer. The reason for the delay is the existence of competing acquisition offers of DANDYS by other State and private firms. The President of the city indicates that the municipal authorities are inclined to accept the highest bid, but the employees of DANDYS disagree. Their consent for the denationalization of the enterprise was, they maintain, subject to an implied condition that the assets of the dissolved enterprise would be leased to their own, newly organized corporation.

The largest and the most controversial denationalization plan is being implemented by the management and employees of IGLOOPOL, an industrial and agricultural conglomerate. It is one of the largest and the fastest growing Polish firms, employing 37,000 employees. As in the cases of OMIG and DANDYS, the plan has the approval of the employees and the EC. The promoters have already incorporated a public stock corporation whose stated capital in the amount of 14,000,000,000 zlotys was divided into 280,000 shares with par value of 50,000 zlotys each. All shares are restricted and can only be assigned with the approval of the board. A salient characteristic of the plan is that it distributes the subscribed stock among such different classes of shareholders as a State enterprise, cooperatives, private firms, employees, a trade union, a youth organization, and natural persons not employed by the conglomerate. The stock of the employees of IGLOOPOL represents about one-seventh of the original venture capital. The plan assumes that the State conglomerate will be dissolved and its assets leased by the newly incorporated stock corporation. The by-laws adopted by the promoters provide a few interesting rules. For instance, political parties and trade unions shall not conduct their activities during work hours. Political and sport organizations shall not be subsidized by the corporation.<sup>17</sup> They can use the corporation's premises and equipment only subject to monetary compensation.

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17. The local sport club has acquired enough stock to live on future dividends. Ironically, to justify the issuance of stock of a certain par value to the club, two interesting transactions

A distinguishing feature of these and other denationalization plans is that they are usually promoted by the management of profitable firms. The employees' confidence in their managers' competence is a key factor for the success of all privatization schemes.

These first experiments in denationalization have been both hailed and condemned. Apart from criticism by the conservative socialist ideologists, they are also criticized by the followers of the popular employee self-government movement. Some critics argue that the experiments are aimed at "disarming" ECs and trade unions. The so-called managerial option is viewed as a disguised plan to endow members of *nomenklatura* with property rights belonging to the State Treasury. This vision, however, involves the danger of alienating or discriminating against many talented managers. Poland cannot afford to introduce "reverse discrimination" based upon class or political considerations. Such policies would restrain the pace of reforms and privatization.<sup>18</sup>

In the absence of denationalization guidelines and procedures, privatization can be abused both by management and labor at the expense of the rest of the society.<sup>19</sup> The most real danger is associated with the existing imperfections of the pricing system and lack of an established financial market. As a result, promoters of privatization currently employed in profitable and lucrative State enterprises can

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were made. First, the management, acting with the approval of its EC, donated their equipment to their sportsmen. Then, that capital, a boxing ring, was invested in the newly incorporated stock company as consideration for the issuance of stock. Compare Zuzelski, *Igloogate*, *Gazeta Bankowa*, May 29, 1989, at 3, 13. Among the secondary promoters of the newly established joint-stock corporation are also firms controlled by the Polish United Workers' Party and the Association of Rural Youth.

18. T. Ash emphasizes that "enfranchisement" of *nomenklatura* also has advantages, namely: "compensating some members of the *nomenklatura* for their loss of political power, and dividing it between those who stand to lose and those who stand to gain" ("*nomenklatura* buy-out theory"). Ash, *supra*, note 2.

19. To prevent such abuses, the Minister of Finances has recently sent an open letter to his fellow ministers and founding organs of State enterprises, in which he outlines denationalization schemes. The letter calls for appraising assets of transformed enterprises in accordance with their current market prices. It requires that paid-up stock should be offered for sale to third parties by way of competitive bidding. Moreover, it suggests that a denationalization plan may authorize employees to acquire bonus stock subsidized from designated assets of the dissolved enterprise. See Letter of the Minister of Finances (June 8, 1989), as published in *Rzeczpospolita*, June 8, 1989. The letter has no binding force and may be characterized as a commentary to the controversial statutes on Conditions of Consolidation of the National Economy, see *supra* note 13. The problem with the application of "current market prices" is that, in the absence of a stock exchange and capital market, it is almost impossible to appraise the value of stock. One also should distinguish between the value of the corporation as a going concern and the aggregate value of its assets.

divide the resources among themselves at a drastically discounted price. They also can arbitrarily close access to their ventures for other investors and offer bonus stock to powerful political allies in the Government, political parties, and trade unions. Poland's economic system, being stripped of free-market pricing mechanisms, will not work any better whether dominated by the followers of the management approach or the partisans of the employees' self-government camp.

#### IV. TENTATIVE SUGGESTIONS AND CONCLUDING REMARKS

The transition to a new mixed-economy system will not be easy. If the privatization process is to be approved by the people of Poland, it must be conducted in a fair and efficient manner. Disposal of State assets should be governed by legislative guidelines and supervised by an independent agency rather than by ECs and employees having vested interests in the outcome of privatization disputes.

Denationalization plans should be published well in advance of the actual transition process, thus allowing ECs, local governments, and other interested parties to challenge them in courts. But the scope of judicial review should be narrow and simplified procedures ought to be introduced to reduce the danger of costly delays.

The existing imperfections of the pricing mechanism, coupled with the absence of the securities market, suggest that an accelerated program of disposal of State assets should be delayed until the price-control system is largely abolished and an effective stock exchange is established. Only these two interrelated measures permit more objectively valued investment assets, shares, and economic performance of newly incorporated companies.

Distribution of State assets among promoters of denationalization plans, whether managers or employees, at discounted prices is detrimental to Poland. Nevertheless, in such a system, credit and tax incentives for potential investors, particularly employees willing to invest in their firms, should be introduced as an alternative.<sup>20</sup>

Because of the weaknesses of Poland's capital market and domestic currency, detailed regulations regarding the scope of foreign participation in the acquisitions of key Polish industries are needed. For instance, foreign investments in domestic securities companies should

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20. British and United States executive share option schemes serve as good examples how to provide incentives to managers. As in the post-war British nationalized industries, Polish managers in State-owned companies are drastically underpaid in comparison with their counterparts in the private sector.

be restricted. On the other hand, the possible role of foreign experts in devising the future securities exchange system ought to be considered.

Experience does not furnish much basis for altering the doubts concerning the case for industrial democracy or employees' control. The vision and competence of ECs are usually directed to advance the interests of the constituency they represent rather than to promote overall solutions for the national economy. But even if the idea of joint management is rejected, structural changes designed to reduce the corporate hierarchy of responsibility for decisions should be established. Such goals can be achieved by competent managers without uniform legislative solutions.

During the transition to a "normal" economic system, Poland should be skeptical about new and untested socio-economic ideas. At a time of growing dependency on the world market, Poland has no choice but to adjust its economic and legal structures to those prevailing in free-market economy countries. The question is, can Poland resist the temptation to experiment with a new utopian public philosophy which promises to give the people of Poland the best of two worlds, the socialist "discipline" at the work place and the capitalist abundance of goods in supermarkets?