Still Restructuring?

The Politics of the Steel Sector Restructuring in Poland

And the Effects of EU Accession

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Abstract

Undertaking consolidation of the atomized Polish steel industry was a solution advocated in the early years of transition, as necessary for the success of the sector's restructuring. The government did not heed the advice, with disastrous effects. Later on, the government also did not use privatization policy strategically, as an effective tool, which would have prevented the need for state-led consolidation efforts. Taken together, the resulting policy option was the worst possible for the sector, yet, in terms of the government's calculus, it was the least costly politically. By avoiding confrontation with powerful vested interests, the government was minimizing its short-term political losses. As for the vested interests, most notably the managers, they were rationally following their best individual strategy, all while realizing that combined, in medium term, their strategies would lead to worse outcomes than those envisaged by the originally proposed reform. When the government finally acted, it was in a crisis situation, which dampened the vested interests' opposition to a previously unacceptable solution. Moreover, with EU negotiations underway, the government's bargaining power vis-à-vis powerful vested interests increased, as to a significant degree, its hands became tied by the European Commission's requirements.

Secondly, the paper argues that the adequacy of economic policy tools differs according to sector. The Polish case suggests that in a transition setting, the restructuring of capital-intensive industry with high sunk costs requires decisive, strategic, state action through sectoral industrial policy, rather than mere reliance on market forces. Given the investment needed for technological restructuring and capital replacement, as well as for alleviation of social consequences of restructuring, even horizontal industrial policy tools may not be enough.

I. Introduction

This paper is part of a larger dissertation project, which investigates the question of the determinants of timing of privatization of the largest steel mills in four Central and Eastern European countries: the Czech Republic, Poland, Romania, and Slovakia. The project is aimed at explaining the puzzling question of why privatization of the largest steel mills in the Slovak Republic and Romania, two countries not in the forefront of EU accession, preceded such privatization in both Poland and the Czech Republic. After all, the latter two's placement in the first wave of accession to the EU was never seriously questioned and yet both had significant problems finishing negotiations with the EU precisely over the issue of the steel sector restructuring.[1]

This paper attempts to explain the causes of the relative failure to restructure successfully and to privatize Polish steel industry, as it examines state policy toward the sector from the perspective of the interaction between the government and the vested interests involved. It also assesses the role the EU played in shaping policy towards the sector. Given the EU's sensitivity to the steel industry, one would have expected the sector to be an area of particular attention for successive governments. All the more so since Poland was aiming to join the EU in the first wave of accession.

The paper argues that the vested interests, most notably the managers, were rationally following their individual restructuring strategies, all while realizing that combined, in medium term, these strategies would lead to worse outcomes than had a coordinated reform of the sector taken place. Successive governments, on the other hand,

[1] Slovakia's temporary exclusion from the "first wave" of accession was political, rather than economic, in nature.

minimized potential political losses as they eschewed complex, sectoral solutions, first proposed as early as 1992. EU accession helped break this vicious cycle in two ways. Liberalization of trade, among other factors, resulted in an economic "war of attrition," which, while leading the entire steel sector to the brink of bankruptcy, dampened opposition to sectoral consolidation. The latter had also been made easier by the EU's competition policy requirement of developing a restructuring strategy enabling particular enterprises, which use state aid, to attain economic viability by the year 2006.

The paper is composed of eight sections. Section I provides an introduction, Section II presents the challenges the sector faces, Section III discusses the condition of the steel sector in Poland, and Section IV lays out the initial reform attempts in the sector. Section V provides an explanation as to why these initial reform attempts failed while Section VI discusses actual forms of state involvement in restructuring during transition and includes a treatment of privatization policy. Section VII is devoted to a discussion of the effects of the EU on state policy toward the steel sector. Section VIII concludes.

II. Challenges the sector faces

Steel industry is a case, which can be treated as a perfect lens through which to examine the challenges of both transition and EU accession. On the one hand, it represents heavy industry and is thus an exemplar of the most difficult restructuring tasks faced by the manufacturing sector as a whole. On the other, as a "sensitive industry" in the EU, it became a bone of contention in membership negotiations.

One may summarize the systemic challenges that the steel sector faced as three-fold. The first one is connected with transition itself, especially with the collapse of the Soviet Union. Given that the USSR was the major recipient of east-central European steel, system change in these countries, the subsequent demise of the USSR and accompanying breakdown of CMEA, led to a substantial production overcapacity.[2] At the time of system change, the industry suffered from many of the traditional syndromes of communism: it was technologically backward, overgrown, lacked a market-driven production profile and suffered from redundant labor. Combined, these factors made adjustment to a global market economy all the more difficult.

Global crisis on the steel markets further exacerbated the transition-related challenges. With steel market suffering from a general production overcapacity, it is very difficult to compete with the far more efficient western producers on the one hand and inexpensive Asian producers (and also increasingly Russian and Ukrainian ones) on the other.[3]

European integration was a source of additional strain for the sector. Given that the EU countries had over the past twenty years undergone a very painful restructuring process of their steel industry, they opposed lenient treatment of the applicant states. The Europe Agreements, signed by the successive countries in the early-mid 1990s, provided for a step-wise liberalization of the steel products in the late 1990s. Moreover, state aid to the sector was to be coupled with the reduction of production capacity. This follows current EU rules on state aid. Their application in the accession states was intended to

[2] While in 1989, 33.4% of Polish iron and steel industry exports went to the USSR, the number dropped to 15.8% in 1990 and less than 1% in 1991 and 1992. See Barbara Pytel. 1995. "Sector Study of the Iron and Steel Industry in Poland." *Emergo* Vol.2, No.3, p. 32. Thus, one may say that a drastic reduction of trade in steel products preceded the USSR's breakdown.

[3] In the absence of technological upgrading, the accession countries' steel producers are not able to compete with their western competitors as far as the quality of steel is concerned. At the same time, they

prevent a situation in which accession countries' steel plants would, with state assistance, become a future competition threat to the steel producers of the current member states.

III. The condition of the steel sector in Poland

In its *2002 Regular Report on Poland's Progress Towards Accession*, the European Commission's assessment of the extent of both, privatization and restructuring of the Polish steel industry (and other heavy industry sectors as well), was negative. According to the Commission:

> "Although Poland is well advanced in its programme of privatisation, the State continues to own a dominant stake in a number of Polish companies in sectors such as steel, energy, gas, petrochemicals, heavy chemicals, air transport, railways, spirits, sugar and the armaments industry. The aim of the Government, as presented in the medium-term strategy, is to complete ownership transformation by 2005, when Poland should reach an ownership structure similar to that of EU countries, i.e. where the value of state assets represents 10-15% of GDP, compared with 32-34% at present...*Considerable efforts must still be made, most notably with regard to steel and other heavy industries, such as coal, chemicals and the armaments industry...In order to complete preparations for membership, Poland's efforts now need to focus on seeing through the restructuring process, notably with respect to steel and other traditional industries*."[4] (emphasis added)

The Polish steel sector's performance, both financially and in terms of international competitiveness, supports the Commission's criticism. So does a study undertaken by the Supreme Chamber of Control (NIK), which assessed the extent and effectiveness of restructuring and ownership changes in the steel sector during 1993-2001. According to NIK, "...no improvement was made as far as economic efficiency of

are increasingly less competitive cost-wise when compared with the Russian or Ukrainian producers, whose steel products are of similar quality.

the sector is concerned, its efficiency constantly deteriorated. Out of 25 steel mills ... 7 mills went into bankruptcy or liquidation. The rest found themselves in a difficult economic situation and were unable to finish investments. Carrying on economic activity with losses, they also lacked sufficient means for financing current production."[5]

All in all, NIK concludes that the successive governments did not reach the goals laid out at the outset of the restructuring process: international competitiveness, economic efficiency, adjustment of size and type of production to market needs, as well as privatization and capital inflow.[6] To be exact, only one steel mill had been privatized through capital privatization to a strategic foreign investor in 1992 (Lucchini Warszawa Steelworks). Nine steel mills were privatized using bank conciliation agreements, while five were privatized by participating in the National Investment Funds program (mass privatization). Both ownership types are passive. The rest of the mills, representing over 70% of Polish production capacity, were commercialized.[7]

Financial condition of the sector

Table 1 below illustrates the deteriorating financial performance of the steel sector during 1997-2001, including decreased revenue, increased losses and corresponding lower profitability of the sector.

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[4] Commission of the European Communities. *2002 Regular Report on Poland's Progress Towards Accession*. COM(2002)700 final. Brussels, 9.10.2002 SEC(2002)1408, p. 93-94
[5] Najwyzsza Izba Kontroli. "169/2002 Informacja o wynikach kontroli restrukturyzacji i przeksztalcen wlasnosciowych w hutnictwie zelaza i stali. Skrot prasowy." Available at www.nik.gov.pl/polski.html
[6] Najwyzsza Izba Kontroli. *Informacja o wynikach kontroli restrukturyzacji i przeksztalcen wlasnosciowych w hutnictwie zelaza i stali*. Warsaw: NIK, February 2003. Available at www.nik.gov.pl/polski.html
[7] Commercialization refers to turning a state-owned enterprise into a joint-stock company, with the Ministry of State Treasury holding 100% of shares.

Table1. The financial performance of the steel sector in Poland, 1997-2001 (all figures in mln. PLN)[8]

	1997	**1998**	**1999**	**2000**	**2001**	**2001/ 1997 ratio**
Revenue	16,207	16,187	14,836	17,901	15,454	95.3%
Costs and expenses	16,334	16,446	16,512	18,801	17,581	107.6%
Share of cost in revenue (%)	100.8	101.6	111.3	105.0	113.8	----
Net losses	119.8	271.8	1,690.0	938.0	2,163.0	1,805.5%
Net profitability	-0.7	-1.7	-11.4	-5.2	-14.0	----
Working capital	4,635.0	4,812.0	4,613.0	4,851.0	4,084.0	88.1%
Stock	1,193.0	2,209.0	1,753.0	2,043.0	1,587.0	133.0%
Accounts receivable	2,285.0	2,266.0	2,606.0	2,579.0	2,283.0	99.9%
Cash and equivalent	171.5	154.0	101.5	105.0	99.1	57.8%
Liabilities	6,085.0	7,925.0	9,212.0	10,103.0	10,333.0	169.8%
Long term	1,809.0	2,726.0	2,810.0	1,713.0	1,267.0	70.3%
Short term	5,176.0	5,199.0	6,402.0	8,390.0	9,066.0	175.1%

Source: NIK p. 32-33

Industry's increasing losses over the past several years are conspicuous. Although this performance should in part be attributed to the difficulties the steel industry faces worldwide, one may note that according to the European Commission's *Regular Report*: "the privatised Slovak steel industry continued operating successfully in a difficult economic environment."[9]

The sector's falling profitability and the difficulties of individual mills in meeting their debt obligations earned the sector a "high-risk borrower" label in 1998, with the banks increasingly refusing to give short-term loans to the steel mills to fund production.[10] On the one hand, the overall short-term liabilities have been increasing, in large part through growing debt to state-owned companies, such as the Polish National

[8] The data is taken from Najwyzsza Izba Kontroli, "Informacja o wynikach..." p. 32-33.
[9] Commission of the European Communities. *2002 Regular Report on Slovakia's Progress Towards Accession*. COM(2002)700 final. Brussels, 9.10.2002 SEC(2002)1410, p. 89
[10] Anonymous interview at The Metallurgical Chamber of Industry and Commerce (Hutnicza Izba Przemyslowo-Handlowa - HIPH), Katowice, July 1, 2003.

Railroads (PKP) or the utility companies. On the other, the amount of cash at the steel mills' disposal has been shrinking, with the 2001 level representing only about 58% of the 1997 level. The shortage of working capital for current production was a constant theme that came up in interviews with the various individuals involved in the steel sector.[11] As a result, the mills cannot take in some of the orders for their products since they lack the necessary working capital to complete them.[12] This only further fuels the vicious cycle of increasing losses and indebtedness.

International and domestic competitiveness

The sector's eroding international competitiveness indicates that its financial performance is not just a function of the sector's general difficulties. As Table 2 below illustrates, while the sector's exports of final products decreased somewhat (the 2001 figure represented 84% of the 1997 value), corresponding imports more than doubled.[13] Since domestic consumption of steel products rose by 15% over 1997-2001, imports represent a growing share of domestic consumption. Taken together, these figures

[11] Research for this paper in part consisted of 22 open-ended interviews, carried out over the summer of 2003. The interviewees were as follows: three top managers at two steel mills as well as the newly created PHS organization; HIPH representatives (2 interviews); six trade union leaders representing the two major trade union associations (Solidarity and SNZZ (affiliated with the communist-successor OPZZ trade union confederation), as well as Kadra, (organizing technical workers within the steel sector); a representative of the Employers' Association of the Steel Sector; four Ministry of the Treasury civil servants who currently or in the past dealt with the steel sector ; three Ministry of the Economy civil servants who currently or in the past dealt with the steel sector; a former Minister of the Economy; a former Deputy Minister of the Economy responsible for the steel sector; Agency for Industrial Development steel sector expert, as well as a journalist and three scholars dealing with the restructuring of heavy industry sectors in Poland.

[12] Interviews at the HIPH, PHS, Huta Florian, Ministry of the Economy, Ministry of State Treasury, as well as press articles, e,g, Barbara Cieszewska, "Wolanie o decyzje." *Rzeczpospolita*, 04.10.2001

[13] While this data indicates import of finished products, the share semi-finished goods had in the 2001 structure of steel imports was about 1.5%, according to *The Polish Steel Industry 2002*, a yearbook published by the HIPH. HIPH. 2003. *The Polish Steel Industry 2002*. Katowice: The Metallurgical

Table 2: Domestic and international competitiveness of the steel sector products, measured in thousands of tons.

	1997	1998	1999	2000	2001	2001/ 1997 Ratio
Net production of steel products	7,766	7,151	6,379	7,514	6,600	.85
Export of final products	2,984	2,321	2,166	2,406	2,500	.84
Export of semi-finished products	1,198	783	824	1,671	1,000	.83
Import of final products	1,327	1,750	2,047	2,225	2,911	2.2
Domestic consumption of steel products	6,109	6,580	6,259	7,333	7,011	1.15
Share of import in domestic consumption	21.7	26.6	32.7	30.3	43.7	2.01

Source: NIK, p. 35

illustrate decreasing international and domestic competitiveness of Polish steel products.

At the same time, one should point out that in 2001 Polish terms of trade had the value of 1.8, with each imported ton of steel worth $486 and each exported ton worth $270. This only aggravates the trade deficit problem suggested by Table 2.[14]

IV. Transition and initial reform attempts

The twilight of communism:

Even before transition started, Polish steel mills had a relatively high degree of autonomy, compared with those in some of the other communist countries. According to the 1981 law on state enterprises, SOEs were governed according to the "3S" rule: independent, self-governing and self-financing. As enterprise directors' appointment, tenure, and decisions were subject to the approval of worker councils, the enterprises developed a considerable degree of autonomy vis-à-vis the ministry responsible for

Chamber of Industry and Commerce, p. 7. The corresponding share semi-finished products held in the Polish steel export structure was over 25%.

industry. In fact, insistence on worker self-governance was an inherent part of the Solidarity postulates as an anti-communist opposition.

As a consequence of the 1981 law, the central planning structures over the steel sector were dismantled. Until 1981, the steel mills belonged to the Iron and Steel United (Zjednoczenie Hutnictwa Zelaza i Stali), sectoral organization, which coordinated the delivery of semi-finished products between the steel mills for further processing, allocated raw materials, set prices, coordinated sales and represented the mills before the relevant minister. The two largest steel mills, Huta Katowice and Huta im. T. Sendzimira, however, received special treatment in that while they were dependent on the Iron and Steel United for allocation of inputs, they answered directly to the minister overseeing the steel industry.[15] When the organization was dismantled in 1981, the Iron and Steel Association that replaced it had little control over the individual enterprises, as it never received the powers that were written into its statute and promised by the Minister for Industry.[16] Autonomy of the mills became the modus operandi and inter-mill cooperation greatly subsided.[17]

Thus, as it entered transition, the Polish steel industry was atomized, with the two largest steel mills competing with each other for the title of the leading enterprise in the sector. Out of 25 mills in 1990, fifteen were involved in steel processing and production, four were predominantly pipe producers, three produced machines and equipment, while three manufactured other steel products.[18] With the exception of two steel mills, the

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[14] NIK, p. 7

[15] This account of pre-1989 condition of the sector is based on an interview with the steel sector expert at the Agency for Industrial Development. Warsaw, July 17, 2003

[16] Pytel, p. 19.

[17] Jan Sztobryn. *Hutnictwo Zelaza i Stali w Polsce Niepodleglej*, Warsaw: ARP, 2001; interviews at the Agency for Industrial Development at the HIPH

[18] NIK, p. 22

industry is located in the southern part of Poland, with sixteen enterprises located in the Upper Silesian region. Two dominant players had been the Katowice Steelworks – Huta Katowice (HK) and the T. Sendzimir Steelworks - Huta im. T. Sendzimira (HTS).

Built in 1954 at the outskirts of Krakow, along with the Soviet-style Nowa Huta district, HTS became Poland's largest steelworks. It was a mill with full production cycle, specializing in flat products. In 1976, at the height of Edward Gierek's western-credited economic boom, HTS's dominance became threatened by a new rival located about 40 miles away – the gigantic Huta Katowice (HK), located in Dabrowa Gornicza, in the heart of Silesia. Technologically, the new enterprise's crude steel processing facilities were very modern, but its final product manufacturing section was never completed. Thus, the flat products manufacturing never got underway, but in addition to semi-finished goods, the mill also manufactured long products, such as rails. One should add that HK became one of the key CMEA crude steel producers. In 1989, all steel mills combined employed about 147,000 workers.

The dawn of transition

As transition started, steel mills, like other enterprises, were subject to the harsh stabilization and liberalization measures of the Balcerowicz Plan. The condition of the sector deteriorated rapidly as domestic industry reduced its demand for steel, and trade with the Soviet Union collapsed in 1991. Growing fixed costs, high interest rates, capital and surplus wages taxes, as well as payments arrears were the typical problems, as in many other industrial sectors. While the industry was still relatively successful in 1990, these problems, which hit with full force in 1991, were already visible.[19]

Sectoral policy mirrage

Given the deteriorating condition of the sector, in March of 1991, the Minister of Industry and Trade commissioned a consortium of Canadian consulting firms to carry out a sectoral study, which would form the basis for future state policy. This represented an intention to engage in sectoral industrial policy, which flew in the face of the neoliberal approach characteristic of the early days of transition. This paper argues that the difficulties of transition necessitated active state involvement in restructuring.

The results of the “Canadian program,” completed in the summer of 1992 were a bombshell in the steel community, not in terms of the diagnosis, but in terms of the solutions the program proposed. In terms of the problems noted, the program pointed to the obsolete and environmentally unfriendly technologies, especially to the widespread use of the open-hearth process, as opposed to the continuous casting technology; to the relative paucity of flat products in the overall production structure; to atomization and to the concomitant lack of specialization of many of the steel mills. All of these were well known ills of the Polish steel industry. However, the proposed solutions to rectify the sector’s problems were drastic.

Using moderate growth forecasts, the consulting firm calculated that Polish steel-producing power be reduced from over 15 mln tons/year to 11.7 mln tons/year while the

[19] Karol Lipowczan. 1992. “Podstawowe problemy polskiego hutnictwa zelaza i stali.” *Problemy Projektowe* (January-March), p. 1

finished goods capacity be capped at 8-8.5 mln tons/year.[20] At the same time, the production profile should be changed from increasingly difficult to sell long products (such as rails, wire, etc.) and the low value-added semi-finished products, to the higher-value-added flat products (especially sheet metal) used in the automobile and appliance industries. In other words, the program advocated a turn away from an emphasis on production quantity in favor of quality and marketability of products, or, a mental shift from the communist emphasis on meeting production quota to the capitalist profit motive. The program provided a detailed plan of how to restructure each of the plants: which sections and production lines to close. The program used a medium-term time horizon of 8 years, with the target year of 2000 as the time when the Polish steel industry would be completely restructured.

There were several key components of the plan. First, the sector was to be consolidated. Key to this process was the merger of HK and HTK so as to eliminate any future rivalry between them as well as to make optimal use of their complementary production strengths. For while HK's crude steel production was its forte, without completing investments guaranteeing higher value-added of production (flat products), it would not be able to survive in the long run. In the case of HTS, its obsolete crude steel production was to be closed by the year 2000 and its cold rolled sheet processing facilities renovated and upgraded. Thus, HTS would specialize exclusively in flat products. Other steel mills were to be grouped together and cooperate according to production profiles. This was to enable them to coordinate their investment, sales and marketing strategies, leading to increased competitiveness. Out of the 26 steel plants considered, seven were to be shut down. Employment restructuring was to be even

[20] One should add that in 1980, Polish production of raw steel hit a record 19.5 mln tons.

harsher, as the total workforce was to be reduced from about 140,000 to not more than 43,000 workers.

The costs of restructuring were estimated at $4.45 bln, out of which $1.65 bln was intended for basic investments, 300mln for social costs of employment restructuring, 550mln for increasing working capital, 1.8bln for renovations and 150 mln for other (smaller) investments. The program called on the government to take decisive action in overseeing its implementation. Not only was an inter-ministerial group to be appointed in order to provide an implementation strategy, the government was seen as a crucial partner in the restructuring process, responsible for solving social problems connected with restructuring of employment.

The Canadian consortium program was the first sectoral program accepted by the Polish government. However, the study was accepted only as a “directional strategy” for the restructuring of the steel industry and a detailed schedule for the restructuring of the sector was supposed to be developed by December 31 of 1993. Basically, the plan remained on paper only and the individual steel mills continued market adjustment measures they started even as the program was being developed. In fact, precisely those enterprises intended for liquidation engaged in most desperate efforts to obtain funds for restructuring. Atomized and small, the steel mills were unable to fund the entire restructuring of their production lines mostly using enterprises’ own resources and bank credits. When the Russian crisis hit in 1998, most enterprises were forced to halt their restructuring efforts in mid-stream, with restructured crude steel production facilities, but lacking upgraded higher value-added production facilities. Taken together, these measures resulted in consequences, which were foreseen by the Canadian program in

1992, and are reflected in the recent financial and international trade competitiveness data.

V. Why initial attempts at sectoral industrial policy failed

In accordance with the logic of path-dependency, the failure to implement the original sectoral program had far-reaching consequences for the outcomes of the sector's restructuring. Most notably, it increased the subsequent political and economic costs of sectoral consolidation as managers had already started technological restructuring on their own. However, one should highlight a fact that was pointed out previously, namely, that the types of investments undertaken largely pertained to crude steel processing and did not adequately consider the ability of the market to absorb the amount of goods produced. While modern crude steel processing was a prerequisite for state-of-the-art final goods production, the managers slighted the importance of inter-mill cooperation and specialization, intending instead to create large, full production cycle, modern plants.

In order to understand the subsequent developments in the history of the restructuring of the Polish steel sector, including its recent consolidation, one needs to comprehend the reasons behind the failure to implement the original program. The latter task would best be accomplished by examining the strength of the two main vested interests vis-à-vis the government: the managers and the trade unions, as well as the motivation of the government itself.

The Managers:

The reaction of the managers could be characterized as an example of a situation in which individually rational action leads to collectively irrational outcomes. As a whole, the steel community realized that the implementation of the program recommendations would benefit it in the medium-long run more than would independent restructuring. However, individual managers hoped that by following the latter route their mills would improve their standing as compared with the one envisioned by the restructuring program.[21] This situation could only be resolved by an institutional solution provided by the government. Representatives of the steel community, in interviews and publications, stress that the steel mills were left to fend for themselves as the state did not provide them with the restructuring tools, which they repeatedly asked for.[22]

The steel community even provided government officials with a plan for an institutional solution to solve the consolidation problem in 1994. Yet, when asked about

[21] This is a different spin of the argument Raquel Fernandez and Dani Rodrik make in "Resistance to Reform." *American Economic Review*. Vol. 81 (1991): 1146-1155. There, while the reform will benefit the group collectively, individuals do not know whether they will be better or worse off under the reform and therefore might choose not to vote in its favor. Here, the managers know what their firms' positions will be after the reform (here, the governmental program), i.e., all are bound to lose to various extent in the short run and most will gain in the medium-long term. They are uncertain, however, as to whether they would not be better off (in short and medium term) if they undertook restructuring individually, without the reform.

[22] See Eugeniusz Raczka (ed.). *Hutnictwo w Polsce na poczatku XXI wieku*. Katowice: SITPH, 2003. This book, published by the "Association of Engineers and Technical Workers of the Metallurgical Industry" summerizes the industry's position: "The Metallurgical Chamber of Industry and Trade [HIPH], created in 1991, numerous times appealed to subsequent prime ministers and ministers responsible for the steel sector, showing the inevitability of the sector's collapse if the government will not support the sector's restructuring. Those appeals, usually remaining without any governmental response, have in 2002 been collected into a "White book" by the HIPH." Supporting this view, Tadeusz Torz, the former chairman of the HIPH said: "The sluggishness of restructuring processes in the iron and steel industry is primarily due to the lack of a coherent industrial policy...In this process there were two currents: restructuring, which was to result from draft programmes – and, indeed, here little has been done – and independent initiatives prompted by the mills themselves. In my view, restructuring has failed because, in the face of disintegration of the entire branch, each director tries to introduce his own transformation programme."

the reasons why the particular proposal fell on deaf ears of the government, interviewee intimately connected to the steel community said he did not know what motivated the government. At the same time, civil servants interviewed who were involved in the process told an interpretation consistent with other events that occurred. According to these interviewees, the steel mill directors lacked the approval of their workers' councils for any kind of consolidation efforts, necessary for the proposed projects to be instituted. They also lacked the will to reduce their own production capabilities, when asked by Marek Pol, the Minister of Industry and Trade at the time, about which steel mills would commit themselves to what kinds of reductions.[23]

Even harsh critics of the relative lack of state involvement in the sector admit that there was a desire for "continued independent existence" on the part of the individual steel mills. Another interviewee from the steel community, when asked why, faced with the lack of appropriate state involvement, did the steel plants not attempt to carry out coordinated restructuring among themselves, through their sectoral organization, said: "Each one wanted to be his own lord, on his own property."[24] Such an opinion was widely shared by other interviewees.

In particular, HTS was opposed to consolidation since its crude steel processing section would be closed by the year 2000 if the original plan was adopted. Such a move would relegate it to a mere "processing plant" and a secondary role in the new entity, a solution obviously neither acceptable to its director (who would lose power and prestige) nor to the mill's labor unions and the workers they represented. After all, closing the

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Quoted in Pytel p. 19. These views have been seconded by the current president of HIPH, both in numerous press interviews as well as in two interviews with the author.
[23] Anonymous interviews, Warsaw and Katowice, July 2003.
[24] Anonymous interview, Katowice, July 2003.

crude steel section meant laying off 6,000 workers. On the other hand, modernization of the crude steel section at HTS would endanger the existence of HK, which, without the flat products facilities would go bankrupt, making 15,000 people lose their jobs in the heavy industry zone of Silesia.[25] Yet, the Polish market was too small to support two large, full production cycle steel mills, especially with the prospect of impending free trade in steel products. In order to facilitate the merger, the Polish government commissioned Arthur Andersen consulting firm to design a merger plan, which was prepared on the basis "of comprehensive polls carried out in both mills." The management of neither steel mill signed on to it (presumably, the manager of HK would also lose power as the new manager of the joined enterprises would be someone else). Rather, the talks evolved in the direction of "greater cooperation" between the two mills, which was never institutionalized.[26]

The Labor Unions:

Labor unions represent the second major vested interest. In general, labor union strength in Poland is waning, as union activities in the growing private sector are much weaker.[27] However, in the declining state sector, especially in heavy industry, labor unions still have the means and power to protest against the decisions made by the

[25] The actual numbers were smaller since labor force in both plants needed to be reduced.
[26] Pytel, p. 22-24, also supported by an anonymous interview at the Ministry of State Treasury, Warsaw, July 8, 2003.
[27] See: Gardawski et al. *Rozpad Bastionu? Zwiazki zawodowe w gospodarce prywatyzowanej*. Warszawa: ISP, 1999. Julisz Gardawski. *Zwiazki zawodowe na rozdrozu.* Warsaw: Instytut Spraw Publicznych, 2001. In fact, the EU *acquis communautaire* regulating industrial relations will actually be empowering private sector workers by granting them greater participation rights inside the enterprise. Interview with Pawel Ruszkowski, labor expert and advisor, Warsaw, May 22, 2003. This is also supported by Magdalena Pustola's doctoral research on worker participation rights in Poland; personal communication, May 2003.

government, as well as the management. This power was especially visible in the summer of 1993, when labor reacted to the hardships of transition and after Solidarity decided to fold its protective "umbrella" over the initial economic reform measures. While the steel industry does not come close to the strike reputation of the mining sector, individual strikes at the steel mills have been important.

In the interviews, the hunger strike at HTS at the end of 1992, whereby workers demanded "full modernization of HTS and the granting of government guarantees for enterprises' technological development" repeatedly came up as one of the reasons for the government's backtracking on the merger plan.[28] In the early 1993, there was a massive wage strike at HK. This only further underscored the volatility within the sector.

At the same time, however, collusion between managers and some trade union leaders was not uncommon. While in an interview, a trade union leader originally from HK accused the management of colluding with the trade unions at HTS in the early 1990s to block the merger plan, other trade union leaders' response had been: "At HK they also colluded."[29] According to interview material with sectoral-level trade union leaders, "enterprise-level organizations usually support the ideas of the managers, which are similar to the expectations of the workers, but do not support the expectations at the sectoral level."[30] While the quote referred to sectoral agreements regarding pay, this could be extended to the wider restructuring policies.

The characterization made by the former Deputy Minister of the Economy and the author of the sectoral consolidation plan of 2001, who, in his own words, "climbed from

[28] Various interviews, summer 2003. On the strike, see Rafal Towalski, "Zwiazki zawodowe w procesie restrukturyzacji sektora hutnictwa zelaza i stali" in Leszek Gilejko (ed.), *Zwiazki zawodowe a Restrukturyzacja - bariery czy kompromis*. Warsaw: SGH, 2003, p. 139
[29] Interviews with trade union leaders, Katowice, July 4 and 7, 2003.

the rank of the worker all the way up to vice-president of the steel mill...I've watched it from the very top and the very bottom," is instructive and worth quoting more extensively: "...There was a symbiosis of interest between top management, middle management, and the trade unionist. There was an informal agreement. In the steel sector, the managers felt where the political power was located and at the very beginning started to pull these labor union leaders into a sort of common game...There was bribery with positions, the managers would appoint the wife of a trade union leader to some position, or his brother-in-law, or would appoint someone from his family to become the president of a spun-off company." When asked for the scale of these activities, the interviewee said "Big! I do not know how to quantify it, but I believe it was absolutely big."[31]

In fact, quantitative data yields support to these observations. As part of a project on labor unions and restructuring, 42.7% of the interviewed steel sector workers expressed the opinion that within the Solidarity labor union "union leaders are mainly interested in their own future and want to gain a seat on the supervisory board." Such an opinion was expressed by 32.5% respondents regarding the SNZZ-affiliated leaders and by 34% of respondents regarding other union leaders.[32]

This does not mean, however, that labor relations within the enterprises are smooth. In general, much bargaining goes on at the company level between the

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[30] Towalski, p. 137.
[31] Interview with Edward Nowak, Krakow, July 15, 2003.
[32] Leszek Gilejko (ed.). *Zwiazki Zawodowe a Restrukturyzacja – Bariery czy Kompromis*. Warszawa: SGH, 2003, p.50-51. SNZZ is affiliated with the OPZZ, the communist-successor trade union confederation. As the authors point out, the reason why Solidarity leaders, as opposed to other trade union leaders, were more often viewed as driven by desire for personal gain might have been related to the fact that with the AWS ("Solidarity Electoral Action") in power, the Solidarity leaders might have had greater opportunities to gain seats on the supervisory boards compared with other trade union leaders. Thus, they had greater incentives to act in a self-interested way (and to be perceived as such by the workers).

management and the unions, especially when the enterprises face tough choices regarding restructuring. And while social dialogue at the sectoral level has become institutionalized, sectoral organizations do not seem to hold much leverage over the individual enterprise unions and do not intervene at the enterprise level. As the leader of one of the major sectoral trade unions stated regarding enterprise-level union leaders from his federation: "I cannot demand, I can only persuade, suggest, ask."[33] In fact, examining correspondence between the Ministry of State Treasury, the management, and the labor unions in both HK (1994-2001) and HTS (1997-2001), deposited at the Ministry of State Treasury archives, the author was struck by the amount of strike threats, protest actions, and calls for the dismissal of managers. According to labor relations research, over the years 1999-2001, in one out of three steel mills there was a conflict between labor unions and the management.[34] Thus, the enterprise-level relations between the management and the labor unions are precarious, with the unions wielding the weapon in the form of the strike threat skillfully in order to reach compromise. At the same time, the managers appreciate union power and the threat they potentially represent to their own survival. As a result, they attempt to harness union power to reach their personal goals, such as survival in position of leadership or enterprise aggrandizement. When the interests of the management and the labor unions coincide, as was the case with the potential merger of HK and HTS, the two actors can form a powerful coalition against government initiatives.

[33] Interview with sectoral-level trade union leader, Katowice, July 4, 2003.
[34] Towalski, p. 141. Note: The nature of conflict was not defined.

The workers:

The interests of workers should not automatically be identified with those of the labor unions but neither should the workers be treated as a single unit. After all, depending on the particular worker's circumstances, such as the type of position she is holding inside the steel mill, her job prospects (e.g., will the section she is working in be liquidated?), her approach to reforms will differ. The labor unions, however, will represent the interests of those who are to lose as a result of the changes underway. Those workers, who will either lose as a result of reforms or who are ambivalent about them, even if they see union leaders as often propelled by self-interest, turn to them as their best available means of empowerment.[35] After all, labor unions provide a solution to the worker collective action problem, especially for those who are to lose in the course of reforms. Thus, even though a sizeable proportion of workers may disagree with the union leaders, unless they act in an organized way (such as through a rival trade union), it is difficult to treat them as an actor in their own right. Rather, these workers would more readily be seen in the category of voters.

Government Response:

The picture that has emerged so far is one of the managers, afraid about their short-term losses, hoping to improve their position as compared with the one envisaged

[35] The variation in worker attitude to change and the relationship between workers and trade unionists inside the enterprise was emphasized by Edward Nowak during interview. "There was a sort of lack of initiative on the part of the workers, who understood the need for reforms...who understood that these changes are going on in the entire Poland, in all the sectors, that there is private property, that the market is being created, that we are opening up, that there are no barriers to competition. They kind of understood this and acquiesced, but at the same time, when it impacted them, they were stepping aside and sending forth the trade unionists, [saying] "do something and be active."

by the coordinated sectoral reform. In their opposition, the managers were assisted by the labor unions, afraid about the short-term job losses. Managerial opposition, supported by union power, vastly increased the cost of reform for the government.

First, the government could lose popularity when faced with a wave of strikes. Virtually all the interviewees, asked about state strategy, claimed that the successive governments wanted “social peace,” which would be threatened by real reform moves in the sector. However, electoral concerns were another consideration. After all, short-term costs of reform could well mean the loss of seats for the governing coalition, not only in the local district, but also in the wider region (crucial in this respect was the heavy industry-dominated Silesian region). As a former Deputy Minister of the Economy said: “Which politician, from whatever party, will tell you that you have to close down his [district’s] steel mill? That would mean estrangement from the party. There were those who said that, they were immediately criticized by the regional lobby.”[36]

Thus, fear of labor unrest (which would translate into lower government popularity), combined with possible electoral losses was a major reason why the government gave up on the idea of consolidation of the sector proposed in the “Canadian study” and why it did not take an active role as an owner. According to Henryka Bochniarz, the Minister of Industry and Trade who commissioned the study, the next minister was unfortunately not courageous enough to make decisions, under pressure both from the trade unions and from the managers, not to consolidate.[37] Rather, the

[36] Interview with Edward Nowak

[37] Interview with Henryka Bochniarz, Warsaw, June 2001. In 1996, the Ministry of Industry and Trade became the Ministry of the Economy. In the summer of 2003, the latter became the Ministry of the Economy, Labor and Social Policy (called here Ministry of the Economy for short).

successive governments chose to concentrate on those types of reform, which were less risky, such as the banking or insurance sector privatization.[38]

There were other important reasons as well, which will be mentioned briefly. The first one was ideological. For the "romantic liberals," as the former Minister of the Economy (also from the post-Solidarity camp) called them, the pragmatic idea of consolidation in the sector went against market principles such as competition.[39] According to a former Deputy Minister of the Economy, "Leszek Balcerowicz, whom I value for thousands of things, unfortunately he and many liberals cast a shadow on the restructuring of the steel industry...they believed, 'do not restructure, an investor should come, each one to a different plant, and let them compete with each other.'"[40] Yet, the specificity of the industry made the solely macroeconomic approach inadequate, as the upcoming discussion of privatization will show. Ironically, the views of not wanting to engage in "central planning" could also be heard from the Ministry of the Economy civil servants, who dealt with the sector as far back as the 1980s...[41]

Secondly, one may argue that there were serious logistical obstacles to the Polish state handling sectoral industrial policy. One reason could be referred to as organizational. Staff at the Ministry of the Economy dealing with the steel sector, contrary to the myth of overexpanded bureaucracies, was about five to six people during the entire transition period. In the Ministry of State Treasury (formerly the Ministry of Ownership Transformation), the numbers were difficult to pinpoint, but were probably similar. Contrary to the Ministry of the Economy, individuals dealing with the steel

[38] Interview with Edward Nowak, Krakow, July 15, 2003.
[39] Interview with Janusz Steinhoff, Warsaw, July 3, 2003.
[40] Interview with Edward Nowak, Krakow, July 15, 2003.
[41] Interviews at the Ministry of the Economy, July 2003

sector in the MST changed frequently. As one civil servant described his workplace: "Such is the beauty of this ministry, that today we are dealing with liquidation, tomorrow with employee buy-outs, capital privatization, commercialization or supervision. If you work here for several years, there are constant changes, merging of departments, new tasks, and the people switch. There is no continuity."[42]

The second reason could be termed institutional. Actual industrial policy had to be supported by concrete institutional solutions, most importantly social dialogue. Such developed at the sectoral level only in 1995, when the negotiations over the Sectoral Collective Labor Agreement for the Employees of the Metallurgical Sector started between the sectoral employer association (established at the insistence of the Solidarity trade union) and the major labor unions in the sector. When central administration joined the dialogue, the tripartite commission negotiations resulted in the signing of the Metallurgical Social Packet in the January of 1999, which provided state support for labor restructuring. This was a long time after the 1992 sectoral restructuring plan was proposed and is perhaps one of the key restructuring achievements in the sector. Using relatively generous provisions of the packet, about 48,000 workers left the industry between 1999 and 2001, bringing the total employment in the sector down to 31,000 in 2001.[43] One should point out, however, that the actual employment figures are larger as many of the workers have moved to the spun-off service firms, many of which are totally dependent on the mother company, as well as often 100% owned by it.

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[42] Anonymous interview #1 at the Ministry of State Treasury. Warsaw, July 2003.

[43] Initially, employment was reduced from 145,000 in 1990 to 78,000 in 1998. This reduction occurred without group lay-offs and often meant that workers were moved from the mother-plant to spun-off "daughter companies." Vast majority of these spin-offs are totally dependent on the mother firm, which very often remains its sole owner. Jozef Paduch and Adam Hernas, "Przekształcenia organizacyjne i restrukturyzacja zatrudnienia w hutnictwie polskim." Instytut Zelaza-Gliwice and Politechnika Slaska – katowice, mimeo, 2002, p. 5

The third reason for not implementing sectoral industrial policy was financial. Given the budgetary problems, it would have been difficult to come up up-front with the sums necessary to actively support restructuring. Still, the author believes that having a viable restructuring plan would have facilitated the search for restructuring support funds, such as loans, from international sources. Secondly, having a concrete restructuring plan that would have taken a complex approach to the sector would have prevented redundant investments in the plants. Ideally, the plan would be treated as an interim strategy before a strategic (most likely foreign) investor would be found. Moreover, such a plan would have facilitated a sectoral approach to privatization to strategic investors, which would have treated separate plants as interdependent units.[44] Inadequate financing of industry's restructuring was one problem. Uncoordinated, redundant investment, which could only have been prevented by the owner's more active role, was another.

VI. Actual state involvement in restructuring until 1997 and beyond

Having missed the window of opportunity for introducing a coherent reform in the early 1990s, the successive governments subsequently let the managers continue with their individual business plans. In fact, despite several draft programs in the mid-1990s, no official government program was adopted until 1998. The individual managerial programs were often based on the managers' personal visions of their enterprises' development. The business plans were backed by analyses carried out by sectoral

[44] As the paper will discuss later on, both Ministry of the Economy and Ministry of State Treasury civil servants complained that the foreign investors were interested in the best-performing (smaller) mills, which the Ministry of State Treasury (and earlier Ownership Transformation) preferred to leave as a bonus during future privatization of the larger, less efficient mills. Implementing a coherent restructuring plan

consulting firms, which were "designed to support the managerial line," such as the need for making particular capital investments.[45] The oversight over the individual mills was carried out via supervisory boards, on which the Ministry of State Treasury had representatives. Yet, according to existing research, interviews, as well as examined documents at the Ministry of State Treasury archives, this oversight was often poor or at least inadequate.[46]

Here, one should underline that the managerial attitude to restructuring was by no means one of resistance to change. However, the managers were generally very selective as to the types of change they wanted to promote. On the top of the list was technological restructuring, especially such that would raise the enterprise's standing compared to its domestic and international competitors and consequently, their own stature. As was intimated before, the managers were more interested in increasing their enterprises' production capacity than in answering the question of whether they would be able to sell their products and to make profit large enough to finish the investments they begun or planned.[47] They were far more cautious with regard to such types of restructuring, which would lead to downsizing of the enterprise, through such activities as breaking the company into smaller units or closing down loss-making sections. One

during early days of transition would have facilitated developing a complex, sectoral privatization plan much earlier.

[45] Interview with Edward Nowak; interview at the Ministry of State Treasury, Warsaw, July 6, 2003.

[46] Maria Jarosz. 2001. "Rady nadzorcze w kleszczach interesow partyjnych i grupowych" in *Manowce Polskiej Prywatyzacji*. Warszawa: Wydawnictwo Naukowe PWN. According to materials examined at the Ministry of State Treasury archives, pertaining to the two largest steel mills, ministry officials demanded change of supervisory board members delegated from the Ministry to serve on one of the mills' supervisory board, as they were deemed to act "to the detriment of the Ministry's interests." Moreover, in an interview, a top manager at one of the smaller steel mills, who had worked in several other mills, complained that according to his personal experience (he did not want to generalize, but said that "it is always best to speak from one's personal experience"), the supervisory board positions were no more than "synecures," with their members expressing little interest in the enterprise's fate or development.

[47] As the most glaring examples of this approach, one may cite the case of Baildon Steelworks and Czestochowa Steelworks.

reason was that a smaller company would be less prestigious on the industrial landscape, leading to a loss of stature by the enterprise director/president.

Another, more important one, was that such changes would inevitably lead to group layoffs. While, with a degree of paternalism, some managers felt responsible for their workers' welfare, there was also a more self-interested motive. The managers realized that mass layoffs would inevitably lead to social unrest in the enterprise and more drastic changes would mean their departure from their leadership position at the mill.[48]

Restructuring, largely through investments in new, more environmentally-friendly technologies, largely took place in response to market forces, with the caveat that the state was not letting the important enterprises go bankrupt. According to NIK, over the years 1993-1997, the State Treasury guaranteed PLN 743.9 mln (~$186mln) worth of loans, which were subsequently paid back on time. While it is presently impossible for the author to say how much the state forgave in terms of tax arrears until 1997, six steel mills were not required to pay the capital tax in 1994 and many of the steel mills' tax arrears were rescheduled, while some were forgiven. According to the interviews,

[48] Speaking in the context of the initial downsizing plans at HTS, a former steel mill manager currently associated with the Association of Employers of the Metallurgical Industry, said of the former HTS management: "No one could have been enthusiastic [about the initial plan] when faced with the problem of liquidating three basic units and cutting employment almost in half. No one is eager to take on this burden. Usually, the one who is in management, no matter who he is, he knew [sic] that if he will be the one to do it, then he will no longer stay at the mill. Because he will be so unwelcome by the crew, that it will be best if he departs, or is promoted, or banished, cast away, after doing the job. This is the kind of job that is thankless. When one prospers, develops the firm, hires workers, then one is a well-received president, but when one needs to fire [workers], downsize, no one will look at him but will simply say "this is a tyrant who oppresses us." Anonymous interview, Katowice, July 10, 2003. A similar statement was made by Edward Nowak, as he shared his experience of designing a drastic restructuring plan for HTS after his departure from government. "...opportunism is good, because when one says that "We want a huge mill, which will hire thousands of people," it sounds wonderful. When, in the program that I proposed [as deputy president of HTS], I suggested employment at a level of 4,900 people, with the target employment of 3,200 and currently there are 9,000 [employed] that means that one had to fire half of these people, or

however, public aid to the sector increased rapidly as the sector's financial troubles intensified and the sector became heavily indebted, i.e., after 1998. Moreover, some steel mills were able to obtain the EFSAL loans from the EBRD (European Bank for Reconstruction and Development), which, if used for employment restructuring, were treated as grants.

Precise data starting in 1998 is available, however. Over the years 1998-2001, some of the state-guaranteed loans were not paid back, costing the treasury about $43 million. Other guaranteed loans amounted to about $100mln. Total public aid to the sector over the years 1998-2001 (first half) amounted to PLN 849.7 mln, or about $212mln. The aid was broken down as follows:

Table 3. State aid to the steel sector, 1998-2001 (first half)

Form of State Aid	**PLN mln**
Total	849.7
Budget subsidies	9.4
Overdue Taxes -out of which forgiven	101.7 18.3
Social Insurance Administration payments	124.4 (rescheduled)
Employment Restructuring -out of which EFSAL (EBRD) funds -out of which Polish SME Foundation funds (PHARE-funded)	343.0 5.3 1.5

Source: NIK, p. 62

It should be mentioned that over the same period, the steel mills spent about PLN 3,317.9 mln (about $829.5mln) for restructuring purposes out of their own budgets. What is particularly interesting, however, are the employment restructuring expenditures, the most significant form of state aid in this period. Contrary to what is often perceived as a

put them in spun-off companies, best if private. And of course, when I proposed this program, it was easier strong helping hand from the EU, the state budget, along with the individual steel mills bears the brunt of employment restructuring costs, with less than 5% of the employment restructuring costs connected with the Metallurgical Social Package having been covered by EU funds.[49]

Seeing the structure of state aid, one notices the large share of debt forgiveness and debt rescheduling. This leads to the conclusion that sectoral state aid, with the notable exception of employment restructuring support, largely took the form of bailouts. These occurred in emergency situations, when the intervention was largely intended to prevent the key enterprises in the sector, most notably HK, from going bankrupt. This could hardly be characterized as sectoral industrial policy. And while at the end of the 1990s, the state also used para-budgetary agencies to prevent critical bankruptcies in the sector, these, again, took the form of dealing with "cardiac arrests" rather than engaging in preventive care.[50]

The state, however, employed other tools, falling under the rubric of horizontal industrial policy, whereby all economic actors meeting certain criteria were eligible for consideration. Most significant in this respect has been the 1993 *Law on Financial Restructuring of Enterprises and Banks*, which introduced such measures as the bank conciliation procedure and other forms of debt workout. While some have treated it as a

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for someone else to point to me and say: 'He's the one who wants to fire you.'"

[49] See, for example Preston Keat. "Penalizing the reformers: Polish steel and European integration." *Communist and Post-Communist Studies* 33 (2000), p. 214 "the EU will pay a significant portion of the cost of pensions, retraining and early retirement." Actually, according to an interview at the Association of Employers of the Metallurgical Industry (Katowice, July 10, 2003), out of PLN400.5mln, only PLN7.9mln (for the purposes of training contracts) came in the form of EU aid, while the rest was paid by state budget.

[50] One such form was the use of the *Agency for Industrial Development*, as well as the *Silesia* Financial Association to obtain working capital, first for HK, later for Czestochowa Steelworks and then other enterprises in the sector. While the *Agency for Industrial Development* bought out some of the steel mills' bank debt, guaranteeing solvency vis-a-vis banks, the *Silesia* Financial Association purchases raw materials and inputs and lends them to Czestochowa Steelworks to be paid for after sale is completed. As both

welcome and necessary corrective to the initial neo-liberal set of reforms, the measure has increasingly been seen as an important element of the relatively successful economic transition in Poland, at least as measured by GDP growth.[51] Unfortunately, this form of state intervention was not sufficient to enable the steel mills to restructure successfully. While participation of the nine mills that took part in the procedure enabled most of them to survive, it did not generate additional resources to enable them to finish the restructuring process. Three of them went bankrupt.[52]

The question of privatization

Not only would sectoral consolidation have facilitated rationalization and optimization of the steel mills' investment and marketing strategies, thereby helping them to attain viability, it would also have been more conducive to developing a comprehensive and profitable privatization policy.[53] As in majority of cases, privatization

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agencies are joint-stock companies, independent of the budget and operating according to market rules (though, at least in the case of AID, 100% state-owned), their assistance does not legally represent state aid.

[51] See Lawrence King and Aleksandra Sznajder. "The State-Led Transition to Liberal Capitalism." Yale University, mimeo, 2003 and Gerald McDermott, "Institutional Change and Firm Creation in East-Central Europe: An Embedded Politics Approach," The Warton School, mimeo, 2002. For a detailed analysis and assessment of these debt workout procedures, see Gray, Cheryl, and Holle. 1996. *Bank-led Restructuring in Poland: An Empirical Look at the Bank Conciliation Process*. Policy Research Working Paper, World Bank, # 1650 and Gray, Cheryl and Holle. 1996. *Bank-led Restructuring in Poland: Bankruptcy and its Alternatives*. Policy research Working Paper, WB 1651, as well as Anna Krajewska. 2001. "Efektywnosc Restrukturyzacji Finansowej Przedsiebiorstw. Aspekty Oddluzeniowe ["Effectiveness of Financial Restructuring of Enterprises. Debt relief aspects"] in Elzbieta Maczynska (ed.) *Restrukturyzacja Przedsiebiorstw w Procesie Tranformacji Gospodarki Polskiej* [*Enterprise Restructuring in the Process of Transformation of the Polish Economy*]. Warsaw: Wydawnictwo DiG.

[52] NIK, p. 40. One may argue counterfactually, that without this procedure all would have ended up in bankruptcy.

[53] Some could argue that a comprehensive privatization strategy using strategic investors early on in the transition process could have been used as a tool for restructuring the sector. However, given that privatization can be a long process, the mills needed to make adjustment to market conditions, which they could not postpone until potential privatization took place. Thus, basing privatization strategy on prior sectoral restructuring strategy leaves a safety valve in the form of a set restructuring agenda should privatization not materialize as quickly as expected.

using National Investment Funds was largely unsuccessful in the case of those steel mills, which participated. This was to be foreseen, as given the sector's high sunk costs and capital intensity, restructuring would best be performed by a strategic investor, able to make the necessary investment.[54] Yet, the sector's privatization policy was equally haphazard as the restructuring policy. According to NIK, successive governments lacked clear vision of the privatization policy. "According to the Chamber, the basic reason for the lack of privatization of the biggest steel mills was inadequate rank assigned to privatization in subsequent *Restructuring programs* as well as delayed by several years action on the part of subsequent Ministers responsible for privatizing the steel mills."[55]

According to the former Minister and Deputy Minister of the Economy, as well as some of the interviewed civil servants, there were tensions between the Ministry of the Economy (former Ministry of Industry and Trade), responsible for developing restructuring programs, and the Ministry of State Treasury (former Ministry of Property Transformation), responsible for both privatization and ownership oversight. While on the one hand, in the latter part of the 1990's, the Ministry of State Treasury believed that privatization was to take place prior to restructuring, it did not undertake decisive action in order to bring capital privatization about. And whereas interest of foreign investors in some of the smaller, more valuable mills such as the Florian Steelworks, was abundant as early as mid-1990s, the Ministry was reluctant to sell the enterprise. This would mean "getting rid of the pearls," which could later be used as a bargaining chip when privatizing the larger enterprises.[56]

[54] NIK p.43-45
[55] NIK, p. 47.
[56] Interview at the Ministry of the Economy (Warsaw, July 14, 2003) and the Ministry of State Treasury (Warsaw, July 8, 2003), as well as with several managers at Huta Florian (Swietochlowice, July 22, 2003).

On the other hand, no specific steps were taken to develop a coherent privatization plan involving the entire sector, or its strategic players. In fact, privatization appeared as a goal of the 1998 *Restructuring Programme for Polish Iron and Steel Industry,* and the steel mills were to be privatized until the year 2001. However, according to the former Deputy Minister of the Economy, the plan represented more of "wishful thinking" rather than a concrete strategy.[57]

Obstacles to privatization of the two biggest steel mills were closely related to the lack of merger between HK and HTS or at least to the lack of a coordinated policy within the sector. Potential foreign investors interested in HTS wanted a guarantee that HK would provide the necessary crude steel for further processing, which HTS produces in inadequate amount. Moreover, given the size of the Polish market, the foreign investor wanted to be informed about HK's production and development plans in the future, as such could impact her own business strategy. As one interviewee put it: "the investor wanted to know whether Poland will have one or two flat sheet producers."

Particularistic politics led by the steel mills, combined with the government's indecisiveness, led to a series of privatization failures. Voest Alpine's attempt to invest in HTS represents perhaps the most blatant example of the lack of a clear privatization policy and inadequate ownership oversight. While Voest Alpine along with Hoogovens were interested in investing in both HTS and HK at the same time, British Steel was only interested in purchasing HK. Yet, the president of HK, having authorization from the Minister of the Treasury to lead privatization negotiations, dismissed Voest Alpine/Hoogovens' offer in favor of negotiations with British Steel, claiming that its offer was better for HK. "The Austrian-Dutch proposal actually intended to consolidate

[57] Interview with Edward Nowak.

the two enterprises, but from Huta Katowice's point of view, was too weak," said HK's president in an interview.[58]

In other words, the Minister of Treasury delegated his responsibility to the management of one of the interested enterprises (which would obviously take its own and not the sector's interest into account), rather than trying to broker a deal among all the investors.

The story of restructuring and privatization of the Polish steel industry can only be continued by introducing the EU explicitly into the picture. EU's importance as an actor within the steel sector grew rapidly after 1997.

VII. The EU steps in

The EU effect on the policy of the Polish state towards the steel sector could be compared to a vise, with one part of the vise employing pure market measures and another relying on industrial policy, albeit one that does not distort competition. In other words, the EU forced the Polish state to employ both, bottom-up (market-driven) and top-down (state-driven) policies, even though the latter element was more pronounced only as the final negotiation deadline approached. The market-driven approach was based on progressive trade liberalization, forcing the sector to face stiff competition, which nearly brought it to the brink of bankruptcy. The top-down approach, necessitated by the EU competition policy, required the development of a restructuring strategy enabling particular enterprises, which use state aid, to attain economic viability by the year 2006. Thus, the state needed to pressure the enterprises to submit credible business plans, approved by an outside auditor, which would enable them to attain viability. The numerous drafts of the final restructuring program, which the Polish government

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[58] Jan Dziadul, "Stal na zlom." *Polityka*, 13 February, 1999, p. 63.

proposed to the Commission and which largely differed regarding the details of the individual mills' business plans, shows that this was no easy task. It also shows that the requirements the EU placed on the Polish state during membership negotiations actually strengthened its position vis-à-vis the enterprises and the vested interests in the sector.

The work on an updated sectoral program started speeding up as the first phase of trade liberalization with the EU approached and was accompanied by altercations with the Commission over the renegotiation of duty levels. According to Protocol 2 of the Europe Agreement, which laid out the duty reduction schedule for the sector, trade in steel products was to be fully liberalized by the year 1999. Under pressure from the Polish steel industry, however, the government undertook successive renegotiations of the amount by which duties were to be reduced. These renegotiations had been a source of tension with the Commission, which was itself pressured by the EU steel lobby. In 1996, the Polish government applied for retaining the 1996-level duties in 1997. In its argumentation, it cited the possibility of invoking article 28 of the Europe Agreement, which allows for protection measures for industries undergoing restructuring or difficulties that have serious social repercussions. While the Commission did not approve the use of the clause for the steel sector, it reluctantly agreed to retaining the 1997 duties at the 1996 level. At the same time, the 1998 reduction was supposed to be carried out as originally envisioned, i.e., the duty rate was to be lowered from 9 to 3%. In 1997, the Polish government insisted on maintaining the 9% duty in 1998, but the Commission categorically protested, threatening with retaliatory measures and anti-dumping cases. After protests from Germany and Spain, a two-step reduction of duties took place in 1998, 6% for the first half of the year and 4% for the second. Total liberalization of trade was postponed until 2000, with a 3% tariff in 1999. This, however, fell short of both, earlier informal agreements with the Commission, as well as the Polish government's expectations.[59] On the other hand, the renegotiation efforts were often portrayed by their opponents as attempts to renege on a prior agreement as well as an effort to forestall the necessary restructuring. Table 4, below, compares the duty reduction levels envisioned by the Europe Agreements to the actual ones.[60]

Table 4. Planned and actual Polish duties levied on EU steel products, 1995-2000.

	1995	1996	1997	1998		1999	2000
				I	II		
Europe Agreement	12	9	6	3	3	0	0
Actual rates	12	9	9	6	4	3	0

Source: Andrzej Munko, "Ocena i stanowisko Unii Europejskiej w odniesieniu do procesow Restrukturyzacji Przedsiebiorstw w Polskim Przemysle Hutnictwa Zelaza i Stali (1990-1998). Warszawa: INE PAN, 1999. Working Paper No. 13, p. 36

During the disagreements between the Polish government and the Commission concerning levels of duty reduction, a far more important issue took center stage: the question of state aid to the sector and the concomitant reduction of total production capacity. According to Europe Agreement, all state aid given to the sector after 1997 needed to be approved by the Commission. In order to concede to it (some of it retroactively), however, the Commission first needed to approve the sectoral restructuring program. The program required a comprehensive restructuring plan, which would allow enterprises receiving state aid to attain viability in a competitive market environment.

[59]Andrzej Munko, "Ocena i stanowisko Unii Europejskiej w odniesieniu do procesow Restrukturyzacji Przedsiebiorstw w Polskim Przemysle Hutnictwa Zelaza i Stali (1990-1998). Warszawa: INE PAN, 1999. Working Paper No. 13, p. 34-36. Jerzy Sadecki. "Beda negocjacje z Unia Europejska." *Rzeczpospolita*, 21.06.1996; Jedrzej Bielecki. "Polska odmawia otwarcia rynku hutnictwa. *Rzeczpospolita*. 15.11.1997; Jacek Safuta. "Stala w stal." *Polityka*. Nr. 44, 21.10.1998; Jedrzej Bielecki. "Coraz dluzej, coraz trudniej." *Rzeczpospolita*. 04.02.1999.

The program was also to include an assessment of expenses needed to attain viability. The question of state aid was crucial in this respect, as state funds could not be used for new investments. They could be used for employment restructuring (e.g., severance pay for laid-off workers) or debt reduction and had to be accompanied by cuts in production capacity. As part of competition policy, this was intended to reward those enterprises, which undertook restructuring without state aid. While, as mentioned previously, the individual steel mills were required to develop business plans meeting these objectives, the state played a coordinating function.

From 1980 until 1998, EU steel producers limited their production capacity by 60 mln tons a year and laid off about 600,000 steel workers, all while obtaining hefty state support of 45 bln ecu. Given the very painful nature of the restructuring process, those countries, which suffered the most as a result, were very sensitive to the idea of public aid violating competition policy provisions being granted to their Central and Eastern European competitors. Thus, as the applicant states' economies would grow, so would their demand for steel and the smaller their production capability, the less of a competition threat they would represent on domestic and EU markets. Consequently, given the already existing overcapacity on the European steel markets, EU steel producers lobbied for the biggest possible reduction in production capacity of the applicant states as part of any state aid agreement.

The question of maximum production capacity reduction, while seen by some Polish steel producers as an effort to limit their developmental potential, seemed to be accepted with a combination of political correctness regarding EU membership and the understanding that “these are the rules of the game.”[61] Thus, while the 1996 draft of the restructuring program (which was never accepted as an official government document) raised the original 11.7 mln ton crude steel/year production capacity to 13.3 mln ton crude steel/year, the final agreement was much closer to the original estimates.

As pointed out at the outset of this section, the development of business plans by the individual steel mills obtaining state aid, which would conform to the overall sectoral program objectives was no easy task. The discussions between the EU and the Polish government were painful, as the EU demanded yet new and more detailed versions of the implementation plan. In fact, in the fall of 2002, negotiations concerning the steel sector were the main element, which blocked the closing of the competition policy chapter. Without having a detailed plan as to how exactly the state aid funds would be used in the sector, the Commission was refusing to close the negotiations. For their part, the individual steel mills were dragging their feet in providing the materials to the Commission.

Nonetheless, even though the competition policy chapter was finally closed under heavy Copenhagen Summit deadline pressure, the Commission approved Polish restructuring program only on January 29, 2003. The final of the final versions of the sectoral restructuring program, bearing the name *The Restructuring and Development of Polish Iron and Steel Industry till 2006 adopted by Council of Ministers on 10th January 2003,* with changes adopted on 25th March, 2003, was submitted to the Commission. This program, treating privatization as its inherent component and part of strategy, is to form the basis for the restructuring efforts. These are to restore viability to the steel mills

[61] This impression came across in the interviews with steel sector representatives, civil servants, as well as trade unionists. The interviewed former ministers saw integration as a strategic opportunity to change

by 2006, all while meeting the competition policy criteria for state aid. Most significantly, however, program implementation is to be monitored by the Commission, which should have a significant effect of binding the government's hands regarding implementation and consequently strengthening its position vis-à-vis the enterprises and the vested interests.

One of the interviewees from the Ministry of Treasury referred to the EU pressure as a "pistol to the head," which finally forced the government to develop a detailed restructuring plan. The plan uses consolidation idea first set out in the 1992 sectoral study, which, following a string of privatization failures and the looming danger of bankruptcy, was revisited in the year 2000. The consolidation idea was proposed in the sectoral development program, called an *Update of the [1998] Restructuring Program for Polish Iron and Steel Industry* and enshrined in the *Law on Restructuring of Iron and Steel Industry*, adopted in August of 2001.[62] The law introduced the basic idea of merging the four steel producers in the sector, including HK and HTS, into Polskie Huty Stali (Polish Steel Mills), or PHS, a new economic entity.[63]

Here, one should stress that the 2001 program saw privatization as complementary with consolidation and restructuring. With advanced negotiations underway concerning privatization of the four mentioned steel mills to a single investor, one possible strategy could have been consolidation-via-privatization. Yet, the newly elected government decided to halt privatization talks in the fall of 2001, in favor of undertaking consolidation first and privatizing later. While PHS was created in

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production profile from quantity-oriented to quality and higher-value-added one.

[62] On June 30, 1998, the Council of Ministers adopted the *Restructuring Program for Polish Iron and Steel Industry*, which, representing a set of goals along with the steel mills' independent business plans, collapsed rapidly as the international situation on the steel markets deteriorated.

December of 2002, privatization negotiations began anew in the Spring of 2003 and are ongoing. Even though critics point out that the transformation inside PHS is not proceeding fast enough and that the 2001 privatization opportunity should have been seized, the consensus view seems to be that the creation of PHS is a step in the right direction, albeit ten years late.[64]

The key pressure, which broke the opposition to consolidation, was growing indebtedness of the sector and the specter of bankruptcy for the biggest mills. Trade liberalization, carried out as part of Association Agreement with the EU, only strengthened the financial pressure on the sector. Thus, through market pressure on the one hand and through membership negotiation requirements on the other, the EU strengthened the government's position vis-à-vis the vested interests.

VIII. Conclusion:

Undertaking consolidation of the atomized Polish steel industry was a solution advocated in the early years of the transition, as necessary in order to restructure the sector successfully. The government did not heed the advice, with disastrous effects. Simultaneously, the government also did not use privatization policy strategically, as an effective tool, which would have prevented the need for state-led consolidation efforts. Taken together, the resulting policy option was the worst possible for the sector, yet, in terms of the government's calculus, it was the least costly politically. By avoiding confrontation with powerful vested interests, the government was minimizing its short-

[63] In addition to HK and HTS, PHS also merged Florian Steelworks (Huta Florian) and the Cedler Steelworks (Huta Cedler).

[64] The criticism is not of merging the companies but of the state-led, rather than (foreign) investor-led way in which consolidation was carried out. Interview at the Ministry of State Treasury (Warsaw, July 8, 2003).

term political losses. As for the vested interests, most notably the managers, they were rationally following their best individual strategy, all while realizing that combined, in medium term, their strategies would lead to worse outcomes than those envisaged by the originally proposed reform. When the government finally acted, it was in a crisis situation, which dampened the vested interests' opposition to a previously unacceptable solution. Moreover, with EU negotiations underway, the government's bargaining power vis-à-vis powerful vested interests increased, as to a significant degree, its hands became tied by the European Commission's requirements.

Secondly, the paper attempted to show that the adequacy of economic policy tools differs according to sector. The Polish case suggests that in a transition setting, the restructuring of capital-intensive industry with high sunk costs requires decisive state action through sectoral industrial policy, rather than mere reliance on market pressures. Given the amounts needed for technological restructuring and capital replacement, even horizontal industrial policy tools may not be enough and in the absence of an active owner/strategic investor, the state needs to take on some coordinating functions.

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