

**POLISH MIRACLE
LESSONS FOR THE EMERGING MARKETS**

Polish Miracle

Lessons for the Emerging Markets

Edited by
GRZEGORZ W. KOLODKO
*TIGER, Kozminski School
of Business (WSPiZ)*

ASHGATE

© Grzegorz W. Kolodko 2005

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise without the prior permission of the publisher.

Published by

Ashgate Publishing Limited
Gower House
Croft Road
Aldershot
Hants GU11 3HR
England

Ashgate Publishing Company
Suite 420
101 Cherry Street
Burlington, VT 05401-4405
USA

Ashgate website: <http://www.ashgate.com>

Copy-editing and typesetting by Krzysztof Kwaśniewicz

British Library Cataloguing in Publication Data

CIP and LOC data to be applied by Ashgate

Library of Congress Cataloging-in-Publication Data

ISBN

Contents

<i>List of Contributors</i>	<i>vii</i>
<i>List of Tables</i>	<i>ix</i>
<i>List of Figures</i>	<i>xi</i>
<i>Introduction</i>	<i>xv</i>

PART I: POLITICAL AND SOCIAL IMPLICATIONS OF ECONOMIC DEVELOPMENT

1	Institutions, Policies and Growth <i>Grzegorz W. Kolodko</i>	3
2	Social Confidence Deficit and Sustained Growth <i>Juliusz Gardawski</i>	27
3	Is Rapid, Long-term Economic Growth Likely? <i>Leon Podkaminer</i>	41
4	The Economic Agenda of the Polish Round Table 15 Years Later: Lessons for the Future <i>Władysław Baka</i>	49

PART II: FINANCIAL ASPECTS OF ECONOMIC GROWTH

5	Fiscal Policy from the Perspective of an EU Member State <i>Danuta Gotz-Kozierkiewicz</i>	65
6	Fiscal Policy: Growth Booster or Growth Buster? <i>Jacek Tomkiewicz</i>	81
7	Effective Public Finance Management as a Factor of Long-term Growth <i>Marta Postuła</i>	99
8	The Efficiency of the Warsaw Stock Exchange <i>Andrzej Sopoćko</i>	115
9	Pension Funds and the Acceleration of Economic Development <i>Jan Monkiewicz</i>	133

**PART III: POST-SOCIALIST EMERGING MARKETS
AND THE EUROPEAN INTEGRATION**

10	The Role of the Structural Funds and Cohesion Fund in the Stimulation of Sustained Growth <i>Jacek Szlachta</i>	171
11	Implications of the Monetary Union Convergence for the Rate of Growth <i>Witold Małeck</i>	191
12	The Impact of Membership in the European Union on Economic Growth in Poland <i>Danuta Hübner</i>	207
PART IV: THE 'NEW ECONOMY' AND THE OLD PROBLEMS		
13	The Aggregate Contribution of ICT to Output and Labor Productivity Growth in Transition Economies <i>Marcin Piatkowski</i>	233
	<i>References</i>	269
	<i>Index</i>	283

List of Contributors

Władysław Baka, University of Warsaw; Kozminski School of Business (WSPiZ), Warsaw; Minister for Economic Reform (1981–5) and President of the National Bank of Poland (1986–8, 1989–91)

Juliusz Gardawski, Warsaw School of Economics (SGH)

Danuta Gotz-Koziarkiewicz, University of Insurance and Banking, Warsaw; Institute of Economic Sciences, Polish Academy of Sciences; Deputy Executive Director, International Monetary Fund (1995–7)

Danuta Hübner, Warsaw School of Economics; Head of the Chancellery of the President of Poland (1997–8); Deputy Executive Secretary, UN Economic Commission for Europe (1998–2001); Minister of European Affairs in the Polish government (2001–4); EU Commissioner (since May 2004)

Grzegorz W. Kolodko, Kozminski School of Business, Warsaw, and Director of TIGER – Transformation, Integration and Globalization Economic Research – an independent think tank affiliated with that School; Deputy Premier and Minister of Finance (1994–7, 2002–3)

Witold Małecki, University of Insurance and Banking, Warsaw; advisor to the Minister of Finance (1994–7 and 2002–3)

Jan Monkiewicz, Warsaw School of Economics; Technical University of Warsaw; Chairman of the Insurance and Pension Funds Supervisory Commission (since April 2002)

Marcin Piatkowski, Research Director, TIGER, Kozminski School of Business, Warsaw; advisor to the Executive Director, International Monetary Fund, Washington (since May 2004)

Leon Podkaminer, Vienna Institute for International Economic Studies (WIIW); Polish Academy of Sciences (until 1993)

Marta Postuła, Director, Public Finance Restructuring Department, Ministry of Finance

Andrzej Sopoćko, University of Warsaw; Kozminski School of Business, Warsaw; Vice-President, Warsaw Stock Exchange Management Board; Vice-Minister of Finance (2003)

Jacek Szlachta, Warsaw School of Economics; Co-chair, National Physical Planning Committee, Polish Academy of Sciences (since 1992); Chairman, State Council for Regional Policy; expert of the World Bank and the European Union

Jacek Tomkiewicz, graduate of the Cracow University of Economics (AE); research assistant, TIGER, Kozminski School of Business, Warsaw; advisor to the Deputy Premier and Minister of Finance (2002–3)

List of Tables

Table 6.1	Gini coefficient in post-socialist countries	97
Table 7.1	The flexibility of main macroeconomics factors vis-à-vis tax rates	107
Table 8.1	The structure of European stock markets	120
Table 8.2	The structure of investment on the Warsaw Stock Exchange	125
Table 8.3	Changing numbers of companies listed on the stock exchanges in Europe and the Middle East	127
Table 8.4	Asset structure of companies with a large investment potential	128
Table 9.1	Dependency ratios in OECD countries (pensioners to people in working age) (%)	134
Table 9.2	Number of open pension fund members between 2002 and 2003	137
Table 9.3	The significance of pensions fund investments for the economy and financial markets	140
Table 9.4	Net assets of open pension funds (PLN million)	142
Table 9.5	Projection of the net value of open pension fund assets, 2004–10 (PLN million)	143
Table 9.6	Instrument supply on the securities market by category (cumulative), 2004–10 (PLN billion)	144
Table 9.7	Open pension funds' cumulative demand for share instruments, 2004–10 (PLN billion)	146
Table 9.8	Burden on the state budget in respect of contributions paid to open pension funds	151
Table 9.9	Pension Fund Companies (PTE) and Open Pension Funds (OFE) operating in Poland in 2003	153
Table 9.10	Age structure of OFE members as of 31 December 2003	156
Table 9.11	Numbers and totals of contributions transferred to open pension funds by 31 December 2003 (in PLN)	158
Table 9.12	Structure of open pension fund portfolios as of 31 December 2003	159
Table 9.13	Structure of investment portfolios of pension funds in OECD countries (%)	161
Table 9.14	Value of net assets of individual open pension funds between 1999 and 2003	163

Table 9.15	Investment results of open pension funds in 2000–2003	164
Table 9.16	Pension funds in selected countries of Central and Eastern Europe	165
Table 10.1	Effects of the Community Support Framework (CSF) synthetic multiplier on GDP growth in 1989–2010	173
Table 10.2	The impact of the 2004–6 NDP on GDP and unemployment rate	176
Table 10.3	Impact of the NDP on GDP and unemployment rate, assuming annual outlays under the NDP at 3% in 2007–13	189
Table 12.1	Simulated outcomes of macroeconomic integration	214
Table 12.2	Factors affecting benefits from integration with the EU: table of correlation coefficients (correlation coefficients calculated for time cross-section sample, Spain, Portugal, Greece 1981–93, moving 3-period average values)	221
Table 13.1	The contribution of the ICT-producing sector, ICT-using sector and non-ICT sector to GDP growth in CEE countries, EU-15 and USA, 1995–2001 average	236
Table 13.2	Contributions to labor productivity growth (GDP per person employed) of the ICT-producing, ICT-using and non-ICT industries in CEE, EU-15 and the US, 1993/1995–2001	239
Table 13.3	The contribution of TFP growth in the ICT sector to aggregate TFP in CEE countries, EU-15 and the EU, 1995–2001 average	243
Table 13.4	Annual TFP growth and real changes in value added, gross capital stock and labor force in the ICT sector in Poland, 1995–2001 average, in % points	245
Table 13.5	The contribution of ICT capital to GDP growth in CEE countries, EU-15 and the US, 1995–2001 average, in % points	247
Table 13.6	The contribution of ICT capital to labor productivity growth in CEE countries, EU-15 and the US, 1995–2001 average, in % points	248
Table 13.7	Total contribution of ICT to GDP growth in CEE countries, EU and the US, 1995–2001 average, in % points	254
Table 13.8	Total contribution of ICT to labor productivity growth in CEE countries, EU and the US, 1995–2001 average, in % points	256
Table 13.9	Projected ICT capital contribution to GDP growth in Poland for the years 2002–25, average rate of growth	260
Table 13.10	The New Economy Indicator: values for the CEE countries, EU-15 and the US, 1995–2001 average	266

List of Figures

Figure 1.1	GDP dynamics in China, Poland, Russia and Ukraine in 1990–2003 (1989=100)	7
Figure 1.2	GDP dynamics and unemployment rate (1990–2007)	9
Figure 1.3	GDP growth in Poland in subsequent four-year periods, 1990–2001	10
Figure 1.4	Satisfaction with life in post-socialist countries joining the European Union	15
Figure 1.5	Per capita GDP, adjusted for purchasing power parity (in PPS units)	17
Figure 6.1	Internal demand and GDP dynamics (fixed prices)	83
Figure 6.2	Public finance sector expenditure as % of GDP	83
Figure 6.3	Collective consumption and investment dynamics (fixed prices)	84
Figure 6.4	Primary deficit of the state budget	85
Figure 6.5	Borrowing needs of the public finance sector	86
Figure 6.6	State budget revenues to GDP ratio	87
Figure 6.7	State budget deficit	88
Figure 6.8	Rigid expenditure in the state budget	91
Figure 6.9	CIT rate, interest rates and investment dynamics in 1990–2002 (%)	93
Figure 6.10	Gini coefficient in Poland	96
Figure 7.1	State budget revenues in proportion to the total revenues of the public finance sector (excluding EU grants)	100
Figure 7.2	Public finance revenues and expenditures in proportion to GDP (excluding EU grants)	100
Figure 7.3	The structure of tax income in Poland in 2002	108
Figure 7.4	EU fund utilization, maximum variant; payments in millions €, 1999 prices	114
Figure 8.1	Turnover concentration on European stock exchanges (share of the 10 largest companies in total volume)	122
Figure 8.2	Income distribution in society	126
Figure 9.1	Architecture of the new national retirement system in Poland	136
Figure 9.2	Flow of money streams (M) and liabilities (L) in a retirement system	139

Figure 9.3	Ratio of open pension fund demand to total financial instrument supply, 2003–10 (%)	145
Figure 9.4	Stock portfolio and the share of open pension funds in the stock market, 2003–10	147
Figure 9.5	Ratio of open pension fund demand to debt instrument supply, 2003–10 (%)	147
Figure 9.6	Ratio of open pension funds' demand to debt instrument supply, 2003–10	148
Figure 9.7	Use of savings in the retirement system composed of repartition and fully funded components	150
Figure 12.1	GDP per capita in 2002 in EU-15 countries, Poland, the USA and Japan, converted at current exchange rates (thousands €) and in purchasing power parity (thousands Purchasing Power Standards)	209
Figure 12.2	GDP per capita in PPP terms at EU accession time in relation to the EU-15 average (EU-15=100). The previous and present enlargement compared	211
Figure 12.3	Beta convergence in Europe in 1960–2002	216
Figure 12.4	Sigma convergence in EU-15 states in 1960–1997 (variation coefficient for GDP per capita in PPS)	217
Figure 12.5	GDP per capita in PPP terms in Spain, Greece, Portugal and Ireland in 1967–2002 in relation to the Union's average (EU-15=100)	218
Figure 12.6	Change in annual influx of Foreign Direct Investments, centered around the accession date (accession year =100)	224
Figure 12.7	GDP growth in Poland and position of the public finance sector according to ESA 95	226
Figure 12.8	Employment rate in EU-25 countries in 2002	227
Figure 12.9	Relationship between income level and relative volume of social spending in 27 OECD countries	228
Figure 13.1	The contribution of the ICT-producing sector, ICT-using sector and non-ICT sector to GDP growth in CEE countries, EU-15 and USA, 1995–2001 average (based on US ICT deflator excluding semiconductors and computers)	237
Figure 13.2	Contributions to labor productivity growth of the ICT-producing, ICT-using and non-ICT industries in CEE countries, EU-15 and the US (based on US ICT deflator excluding semiconductors and computers)	240
Figure 13.3	The contribution of TFP growth in the ICT sector and non-ICT sectors to aggregate TFP in CEE countries, EU-15 and the US, 1995–2001 average, in % points	244

Figure 13.4	Contribution of ICT capital to labor productivity growth versus GDP per person employed in 1999 \$EKS, 1995–2001 average	249
Figure 13.5	Relationship between real growth in ICT investments and GDP growth in CEE, EU and US, 1995–2001 average	251
Figure 13.6	Relationship between ICT spending intensity (as % of GDP) and TFP growth in CEE, EU and the US, 1995–2001 average	252
Figure 13.7	Total contribution of ICT to GDP growth in CEE countries, EU and the US, 1995–2001 average (in % points)	255
Figure 13.8	Total contribution of ICT to labor productivity growth in CEE countries, EU and the US, 1995–2001 average (in % points)	257
Figure 13.9	Relationship between ICT capital contribution to labor productivity growth and the value of the ‘New Economy Indicator’, 1995–2001 average	258

Introduction

Seven Lessons the Emerging Markets Can Learn from Poland's Transformation

Grzegorz W. Kolodko

It is widely assumed that the **post-socialist transformation started in Poland**. This is true, but only in part. Although it was indeed in Poland that various processes contributing to this dramatic change gained in the 1980s the greatest momentum, things were not at a standstill in other countries of Central and Eastern Europe, either. The winds of change also blew in Hungary or the former Czechoslovakia. But it is true that Poland acted as a trailblazer and was the first to implement many of these changes, which was not an easy thing to do.

Another widespread assumption is that the **post-socialist transformation was set in motion in 1989**, when – first in Poland and then, through a chain reaction engulfing the entire region – ‘real socialism collapsed’ or, as others would prefer to put it, ‘communism was defeated’. Did then the previous system, prevailing for several decades in this part of Europe and in the vast expanses of Asia, simply **collapse** through an insufficient capacity to adapt to the changing internal and external conditions – not just economic, cultural and political, but also technological – or was it, rather, **defeated**, and if so, by whom: by internal forces alone, or by an external pressure? This is a separate question which still remains controversial. Maybe History will provide an unambiguous answer, although I doubt it. For real socialism *did* collapse and *was* defeated. The one does not rule out the other. What is, on the other hand, an unquestionable fact for us is that History sees that very year – **1989** – as a turning point in the history of mankind. Even if it was not the actual beginning of that great change, whose roots went back to earlier reforms – particularly those implemented in Poland, Hungary, and also the former Yugoslavia – it did mark a major shift.

This **great post-socialist shift** consisted in giving up the earlier efforts to reform the old system. The attempts to increase the international competitiveness of the economy and give real socialism a more ‘human face’ had failed. The foundations of the old system thus became abandoned in a fairly radical manner. Rather than go on ‘reforming’ what had proved to be hardly reformable, the endeavor was made to reject the old system and build a new one in its place. This time it was to take the form of a capitalist market economy. Likewise, to be sure, with a ‘human face’.

It is a process which has been going on for 15 years, during which post-socialist countries have gone through many ups and downs, the latter, sadly, prevailing. Excluding China, the greatest economic success story in modern world (as well as Vietnam, following in China's footsteps), in the majority of the 27 countries of Central and Eastern Europe and the former Soviet Union, with over 400 million inhabitants, the output and consumption levels in 2004 remain lower than they were 15 years ago. International statistics demonstrate unequivocally that **the proportion of people marginalized by social exclusion in post-socialist transforming economies has markedly increased**. The areas of poverty and destitution have also expanded, and in some countries life expectancy has dropped, too. Income disparities have increased everywhere, sometimes sharply, although once again to a varying degree. In the majority of societies of the post-Soviet region and the Balkans, the Human Development Index (HDI) as assessed under the United Nations Development Program (UNDP) is now lower than at the beginning of the transformation.

Quite understandably, the situation differs from country to country and, within each specific country, from region to region. Even in a seemingly homogenous country like Poland, per capita GDP in the richest region is about six times higher than in the poorest one. On the international scale, such differences within post-socialist countries are even greater. This is a consequence of both the inheritance of the past – including that of the centrally-planned socialist economy – and, especially, the course taken by the system transformation over the past 15 or so years. Some countries did better than others. Poland is quite universally included in the more successful group. Some commentators even speak about a 'Polish economic miracle'...

Leaving miracles where they belong, it is nevertheless a legitimate question to ask **whether Poland is an economically successful country**. It all depends on the metric of success. After 15 years of transformation, per capita GDP is about 40 percent higher. This is not much of a progress, not only in comparison with China, but also vis-à-vis Western Europe or the United States, that is, the richest countries, which have, on average, developed faster in those years, leaving Poland and other post-socialist countries even further behind. At the same time it is the greatest increase among all transforming economies. In this respect Poland has achieved more than any other country in the region – at least for the time being, as it will only be possible to speak of a true success (or lack thereof) after a longer period than a decade and a half. A final judgment can only be passed from the perspective of generations.

There is no doubt, however, that in many – but, sure enough, not all – respects, **Poland has handled the challenges of the great transformation better than other countries**. This merits reflection and scrutiny and invites comparisons across time and space. Much has been said about it thus far, while many other things remain to be uncovered. But even a cursory analysis of the special case of Poland shows that its better macroeconomic indicators result from two factors.

The first was the **shortest duration of the transformational recession among all countries**. It lasted only for three years – from mid-1989 till mid-1992 – whereas in the extreme case of Ukraine, it evolved into a **great transformational depression** which went on for a whole 10 years. This was a consequence not so much of a sound policy at the outset of the Polish transformation, which was missing as a result of the inane idea of a ‘shock therapy’, as of the positive effects of the market reforms implemented already in the days of socialism. And this is the first lesson that follows from the Polish experience of the times of dramatic change.

LESSON ONE

Economic reforms that increase the flexibility of markets and at least partially contribute towards the building of institutions necessary for the efficient functioning and development of a market economy always come in handy when a bolder and more profound structural shift is subsequently made. Even if certain reasons – for instance, of political or cultural nature – prevent changing too much at one go, it makes sense to change things little by little, for in time this is likely to bring about the desired results. This is not to say that these partial reforms will gain due recognition later on. Most likely they will not, but that does not change the fact that they did take place and prove helpful for long-term development. Politically speaking, someone sows and someone else reaps the political benefits, but the most important thing is the gain for society, economy and state.

Second, the past 15 years has been a heterogeneous period in terms of not only the dynamics of growth, but also the distribution of its fruits and **institution building**, which allowed growth to occur in Poland earlier than elsewhere. The years in question can be divided into four distinct episodes:

1. The initial **‘shock without therapy’ in 1989–93**, when a largely overshoot stabilization policy, disregard for market-economy institution building, excessive and too fast trade liberalization and neglect of the growth-stimulating functions of the state pushed the cost of the transformation well beyond the unavoidable minimum (which was also mentioned in the official documents), while the effects fell considerably below what was expected (and attainable). The actions that led to **sub-optimal effects at an excessive cost were in blatant violation of the basic rules of praxeology**. Consequently, the scale of the transformational recession was much larger than would have been the case had the government pursued an appropriate policy; unemployment reached massive proportions; inflation proved impossible to bring down to single digits and a structural budget deficit began to mount.

2. **‘Strategy for Poland’ in 1994–7**, when the economic institutions became substantially strengthened – allowing Poland to become associated with the

European Union in 1994 and join the OECD in 1996 – and, most importantly, the economy entered a fast-growth path thanks to an appropriate policy of structural reform and development. During those four years, per capita GDP grew at an average annual rate of 6.4 percent, achieving a cumulative increase of as much as 28 percent, which is truly impressive compared to the overall 40-percent growth in the 15 post-socialist years. The increase of income disparities was curbed, as reflected by the Gini coefficient, which stabilized in 1996–7 at about 33 points. There is a lesson to be learned from the ‘Strategy for Poland’ episode:

LESSON TWO

Only a proper mix of two policies – a system change policy and a development policy oriented towards the accumulation and efficient allocation of capital – offers a chance of rapid economic growth. Neglect of either of these components precludes good results. Apart from Poland, this is amply demonstrated in a negative sense by the Russian case and in a positive sense by China.

3. The period of **overcooling the economy in 1998–2001**. Indeed, the word ‘overkilling’ would be just as apt, as growth rate was brought down from more than 7 percent during the last quarters of the implementation of the ‘Strategy for Poland’ to a stagnant 0.2 percent in the 4th quarter of 2001. Such was the result of a doctrinaire approach to financial policy, viewed mostly in instrumental terms, as a tool to suppress inflation and reduce current account deficit. Such a policy could not have brought the expected stabilizing effects, while inevitably causing destruction in the real sphere by hampering growth and aggravating the unemployment problem. Hence the next lesson.

LESSON THREE

Confusing means and ends in economic policy backfires, increasing the social costs of development and decreasing its attainable scale. This sin was rampant not only in Poland and not only during some periods: mixing up policy goals and instruments is a widespread phenomenon in modern world (seen, in particular, in the erroneous advice furnished by the International Monetary Fund and, worse still, its misguided practices). As the means become glorified, they sometimes come to be perceived as ultimate goals, as was the case in Poland in the late 1990s, driving the economy to stagnation. That effect occurred despite the progress in institution building, privatization efforts and the ongoing process of opening up the economy.

4. The **return to the path of rapid development and integration with the European Union in 2002–4** marks a fourth period, differing from the previous ones in the characteristics and dynamics of changes in the system and in the real sphere. A key role has been played therein by two factors of programmatic nature:

profound reorganization attempts in the area of public finance, aiming to adjust the system to the capacities of the state and the requirements of modern market economy, on the one hand, and European integration on the other. The principal policy document in this field was the ‘Public Finance Recovery Program’, in which both the far-reaching restructuring of the public finance system, and the EU accession process were viewed in instrumental terms. Its main task – to restore rapid growth – has been fulfilled. The rate of GDP growth quickly climbed from 0.5 percent in early 2002 to 6.5 percent in the first half of 2004.

It thus becomes apparent that the **success of the Polish transformation in 1989–2004 is made up of a peculiar mixture of ups and downs**. In this context, the abominable performance towards the end of the 1990s, in the real and the financial spheres alike, makes one pause to wonder. After all, the boom of 1994–7 – the years of the ‘Strategy for Poland’ – might have gone on but did not. In a different perspective, after the needless and harmful overcooling of the economy in 1998–2001, the economic misery of those years might have continued to this day, but did not, either.

What do such profound changes in growth dynamics depend upon? Surely, no significant external shocks occurred to account for the great acceleration of 1994–7 or for the great deceleration of 1998–2001. The impact of the Russian crisis of 1998–2001 on the Polish economy was many times less serious than the Polish and foreign propaganda would have it in those days (some reminiscences of that way of thinking still linger on); likewise no other subsequent external shock (this time of a positive nature) occurred to dynamize the economy. In fact, during the four-year period 1994–7, the Russian economy was in a much poorer shape than in the next four years: 1998–2001, and yet no responsible person would have invoked this ‘argument’ to explain why things were not even better. On the other hand, in 1998–2001, the need was felt to explain away many things – namely, the above-mentioned **economic policy errors**. These observations give rise to our next conclusion:

LESSON FOUR

At the time of a great system transformation – in which the liberalization and opening up of the economy go hand in hand with its integration into the global system – institution building, that is, the creation of new rules of the market economic game and a legal and organizational framework for their implementation, is of fundamental importance. But policy is also vital. Ever improving institutions do not by themselves entail – at least not in the short-term perspective – an ever improving policy. The latter may be, alas, steadily deteriorating, for it also depends on other factors, such as the economic doctrine, the dominant political set-up and the skills (or their lack) of those who run the economic policy. Institutions matter, but so does policy.

This is a situation which indeed occurred in Poland: despite the obvious institutional progress – also in connection with EU integration – the economic policy deteriorated. Its particularly weak point was the poor coordination between fiscal and monetary, as well as industrial and trade policies. It only became possible to change this, partly, in mid-2002. It is small wonder then that soon afterwards the economy re-entered the path of more rapid growth. This does not mean, however, that it will automatically stick to this path, as this will depend on the quality of the economic policy, which is an area where new threats emerge.

One would be hard pressed to give an example of economic success based on investing other people's savings. Only in a handful of special cases did foreign investments – especially direct ones, which in the modern world and the global economy are a principal vehicle promoting technology transfer, management quality improvement, the development of marketing abilities and a pro-export orientation in the economy – play a significant (but still not decisive) role in financing economic expansion. Such was the case in Ireland, which aptly utilized the incoming stream of investment, mostly from the Irish Diaspora in the United States. Foreign direct investment also played a significant role in the accelerated growth in the south-east of China. Generally, however, **foreign investments only play a supplementary role vis-à-vis domestic savings**. It makes sense to count on the influx of foreign capital, but one should beware of too optimistic projections in this area. This is another lesson that follows from the experience of post-socialist Poland – not only for the Poles, but also for other 'emerging markets'.

LESSON FIVE

The main source of development financing in all types of so-called emerging markets has been and is domestic capital accumulation. Therefore, its formation should be given the priority it requires in the macroeconomic policy and in the system of microeconomic incentives. What is important, in particular, is the appropriate design of the financial – both fiscal and monetary – policy, which significantly affects the marginal propensity to save and thus has a fundamental influence on the overall rate of capital accumulation and the investment level and dynamics. One can count on others to a limited degree only.

It is best to count on oneself.

This should not be interpreted as an argument against attempts to attract as much foreign capital as possible (or, to use the correct globalization parlance, capital from other parts of the increasingly integrated world economy) – but not at any price. The experience of Poland (among other countries) serves as a dramatic reminder that the influx of foreign capital, if improperly controlled, may lead to excessive dependency on that capital (particularly in the financial services sector), which is not always beneficial for long-term growth. The resulting dependency levels are sometimes referred to as *dependent capitalism*.

Poland stands out as one of the few countries worldwide to have received a **vast infusion of external capital during a very difficult period, crucial for the success of the entire market transformation.** It took a highly peculiar form of forbearance from taking action that would otherwise necessitate a severe outflow of capital from Poland, in connection with the repayment of a large foreign debt. However, in view of the political circumstances, half of Poland's debt became cancelled – subject to some tough conditions, which were met by Poland. Few cases like this have ever occurred worldwide.

One should, nevertheless, hope that their number will increase. **Poor countries should persevere in their efforts to obtain the cancellation of the unrecoverable portion (which may in some cases be the full amount) of their debt to rich countries.** They ought to keep trying until they succeed, as succeed they must. Only the imprudence, greed and shortsightedness of the richer countries prevent this from happening. And when it does happen, the capital flow from more developed to poorer economies will increase. However – and this is yet another significant lesson from Poland – debt cancellation must be combined with sound structural reforms, effective anti-corruption measures and an adequate macroeconomic policy. Debt reduction is sometimes simply inevitable, if a country is unable anyway to pay off its external liabilities. But it only makes economic sense if the consequences of the earlier economic policy errors (excessive debt) are removed along with their causes (faulty policy).

Politicians of the world have united. Not workers – as someone postulated a long time ago – but, of all people, politicians. At least when it comes to shifting the responsibility for their errors onto others, including – interestingly – other countries and *their* governments. This can be seen, for instance, in the powerful United States, whose trade deficit, of structural type though it is, is being blamed – by the Administration – on China and its policy of fixed exchange rate of the yuan, which, as it happens, has been pegged for years on end to the U.S. dollar. Less surprisingly, this trend also occurs in most poorer countries, such as Mali, where the mounting difficulties are attributed (not without reason, this time) to the discriminatory trade practices of the stronger partners from better-developed parts of the world, who subsidize their farmers (and voters), thus suppressing the price of cotton – a commodity of fundamental importance for many countries trying to break out of the vicious circle of poverty.

The countries of post-socialist transformation, including Poland, are no different. **Blaming one's own problems on others has become even easier now that the technological, commercial and financial links between various national economies are stronger than ever.** It is thus simpler (or so it seems to those who engage in such practices) to push the responsibility for the outcomes of one's own incompetence to 'foreign influence and interests'. In Poland, such a reaction was widespread in the aftermath of the erroneous and harmful policy after 1998, overcooling the economy. The consequences of these errors were explained away by invoking the Russian crisis, which in reality affected Poland to a

minimum degree only, due to the marginal importance of its trade with Russia.

Later on – and this tendency is certain to continue – blame for various hardships, which are never lacking, was put on the European Union, although it obviously offers the new member states more than it receives in return. This is not meant to conceal the fact that, in the course of the integration process, the post-socialist accession countries could have obtained more at a lower cost but, alas, failed to take advantage of this opportunity during the accession negotiations. There is a lesson to be learnt here by the countries applying for accession to the EU in the future: Bulgaria, Croatia, Macedonia, Romania and also Turkey.

The general conclusion from all this is as follows: **globalization, which is an objectively inevitable process, presents to national economies new, additional opportunities and chances, but also additional risks and threats.** The two go together. But ‘together’ does not mean ‘in a one-to-one proportion’. The additional benefits (those which would not have arisen save for globalization) may well outweigh the additional costs. But, unfortunately, the reverse is also possible. The whole point is to make apt use of these interrelations in the national strategy of socio-economic development. And this is yet another lesson to learn for all the emerging economies from all corners of the ever more strongly interconnected world, as they keep opening up to broad external contacts.

LESSON SIX

Globalization creates additional development opportunities and additional development threats to everyone. Therefore, the art of economic policy-making consists today in the apt handling of the dilemmas that crop up under the new circumstances. The mini-max rule should be followed: minimize threats, maximize opportunities – or, more precisely, reduce the inevitable costs of participation in the global economic game and increase the benefits thereof.

The Polish case is highly illustrative in this context. The reduction of foreign debt by half; the structural shift in the geographic distribution of foreign trade towards the most highly developed economies, abounding in free capital resources (potentially allocable in Poland) and modern (likewise absorbable) technologies; the influx of a sizable stream of foreign direct investments that reinforce the desired microeconomic restructuring and boost the international competitiveness of enterprises; finally, integration with the European Union – these are just the most significant benefits that Poland has skillfully taken advantage of.

On the other hand, **the exorbitant price paid by Poland for the inrush of short-term speculative capital** during some episodes of its opening up to the world has been (and still is) an additional cost to pay. Too bad, indeed, the price is so steep, but the guilty party is not globalization or capital (greedy by its very nature and ‘speculative’ by definition), but an **erroneous policy of the central bank** (NBP), whose dismal handling of internal interest rates creates international

rate differentials that amount to inviting ‘foreign speculative capital’ to wreak havoc in Poland. This entails losses in the order of billions of dollars, which would be perfectly avoidable. There are countries which have solved this problem, in a variety of ways, including Chile or Malaysia, to say nothing of China and India. **The Polish experience thus indicates not only the right and proper course of action, but also things to steer clear from.** It is best to avoid errors that someone has already committed at some place and time – for instance, in Poland at the beginning and then again towards the end of the 1990s.

The momentous changes in Poland at the turn of the 20th century also teach us quite a few lessons on the borderline between economics and politics. This is compulsory curriculum for all, since everyone has to learn the hard way the interrelationships described above. Even so, it would be unreasonable not to examine the experiences of others. The Poles have learned a great deal, too, analyzing other ‘interesting cases’ (although, perhaps, not *as* interesting as the case of Poland – the most fascinating of all), but some persons in charge of the government could have done better in this respect. In particular, each of the four stages of the Polish transformation of 1989–2004 enumerated above demonstrates that in order to attain economic success, **it is necessary to combine a technocratic and a social approach.**

Economic policy requires a great deal of professionalism. When ‘everything depends on everything else’, it is very difficult to state competently what really depends on what in the tangle of events. One needs to understand this and make use of extensive professional knowledge and technocratic ability to manage huge resources and capital streams.

But this is not enough. An economy does not consist solely of financial and material resources and streams. It is also – indeed, mainly – made up of social capital, people and the relationships that unite them (or divide, as the case may be). Therefore, political activity in the field of economy inevitably entails an involvement in the sphere of social relationships, especially those which arise through economic interaction. In economic policy, ‘to be right’ in the technocratic sense is not enough. One also has to be right in social terms. Which means that the **principal social groups should have a general understanding of the government’s intentions behind its financial, industrial, commercial, regional or investment policies.** Furthermore, even if these groups do not actively support measures intended to put the government program into practice, they should at least give their passive consent for their implementation. Otherwise, the politicians – qua technocrats – may still be right (for instance, when trying to reduce the scope of tax exemptions or to verify the system of social transfers), but society may also be right to reject their ideas. A situation when both sides are right is likely to breed conflict for all. And when both sides stubbornly stick to their respective rights, an open political and social conflict ensues.

LESSON SEVEN

Economic policy is at the same time a technocratic and social endeavor. The neglect of either of these aspects automatically decreases the effectiveness of the policy. It is not enough that narrow circles of experts know what to do: this knowledge must be shared by broad circles of society, although it then becomes a different knowledge. Therefore, the best results in economic policy are provided by an appropriate mix of financial and social engineering, technocratic macroeconomic governance and genuine social dialog, professional pragmatism and social sensitivity.

The past 15 years of market transformation in Poland and its intermittent ups and downs clearly indicate that the economy was doing better when the two above-mentioned approaches were consistently combined. Any deficiency in this respect badly affected the effectiveness of the economic policy. How is this effectiveness measured? The answer follows from one of our lessons, admonishing us not to confuse means and ends: the appropriate measure is invariably the socio-economic dynamics – the pace of financially, economically, socially and ecologically sustainable growth. In those periods when we made sure our homework was done, growth was faster, and vice versa. Obviously, the actor to learn the most from these experiences was Poland – although, regrettably, not all Poles. After all, ignoramuses – whether in politics or at school – are never in short supply. And whereas the Polish transformation has indeed been largely successful, there was most certainly no such thing as a Polish miracle. For there are no miracles. Not even in Poland.

* * *

This volume tackles the key areas of development policy oriented towards closing the gap separating Poland from the richer part of the world. Studies in this field have been conducted for many years at TIGER – Transformation, Integration and Globalization Economic Research (www.tiger.edu.pl) – a think tank affiliated with the Leon Kozminski School of Business, Warsaw (www.kozminski.edu.pl). The present publication is the outcome of another research project coordinated by TIGER. It follows in the footsteps of two other volumes: *Globalization and Development* (Ashgate 2003) and *Globalization and Social Stress* (Nova Science 2004). Many studies devoted to the problems of development in post-socialist transforming economies and emerging markets, as well as globalization and integration, are also made available at TIGER's Web site.

In the 13 chapters that follow, an excellent team of authors, who combine high academic standing with extensive – in many cases – practical experience, not only analyze the upswings and downturns of the transformation period, but also study in depth the conditions for a future economic success, viewed in an extended perspective. Such success should consist in a high rate of sustained growth vis-à-vis

which system changes, institution strengthening and progressive integration within the European Union ought to be seen instrumentally and not as goals in themselves.

The discussion often draws on comparative economics. At the same time, however, it is deeply rooted in the analysis of real economic processes on the one hand and in modern economic theory on the other. Definitely, many of the conclusions are also relevant for other countries, especially those involved, like Poland, in profound structural changes. This concerns, in particular, countries at a low to medium development level which strive for rapid growth and aspire to overcome their persistent economic lag. For sure, they can learn a lot from the Polish experience: what to do and what to avoid in economic policy so as to become ready for economic success.

