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CONTINUITY AND CHANGE
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1. THE POLISH MIRACLE

In September 1993, when the Polish electorate gave an absolute Parliament majority to the reformed successors of the socialist and peasant parties that had ruled in 1989, there was widespread preoccupation for the stability and continued transformation of the Polish economy. There were dismal predictions of “creeping destruction” (former Finance Minister Leszek Balcerowicz) “300 per cent inflation within six months” (former Premier Jan Bielecki), “national catastrophe” (former EBRD Polish Director Jan Winiecki). These fears have been confounded by a most impressive economic performance, the best among transition economies to date.

Under the three governments that have ruled Poland since September 1993 (Waldemar Pawlak, Jozef Oleksy, Wlodzimierz Cimoszewicz) economic growth, which in 1992 had barely resumed, rapidly accelerated to 7 per cent in 1995, the highest rate in Europe east and west. Thus Poland was the first transition economy – and the only one to date – to recover and overtake the 1989 national income level. Being promoted by exports and investment, such high growth is sustainable at rates exceeding 5 per cent in the medium run; it is expected to be about 6 per cent in 1996. Inflation, though still in two digits, has come down steadily to 21.6 per cent in 1995 and is likely to be 17 per cent in 1996 (end-year). In 1993–96 the public sector deficit has been contained under 3 per cent of GDP, while public debt – also thanks to the 1994 agreement which the new government reached with the London Club foreign public creditors – has been falling from 86 per cent of GDP in 1993 to 59.5 per cent in 1995 and is still falling (55.1 per cent in 1996). Thus fiscal policy (unlike monetary policy) actually meets already the strict convergence parameters demanded by the Maastricht treaty for European Monetary Union (which are not actually required for EU accession).
There has been, especially over the last two–three years, considerable restructuring of productive capacity. This is visible through three major indicators. First, industrial output has been growing faster than income, which – especially occurring after industrial output fell faster than income in 1990 to early 1992 – is a clear sign of structural adjustment. Second, empirical studies (such as one by Jo Brada and I.J. Singh, forthcoming in a World Bank publication) have shown that output has been growing faster in those sectors where labour productivity is either higher or has increased faster. Third, labour productivity growth (17% in 1994) is far in excess of the kind of rates which can be attributed to technical progress alone; (by contrast, in 1991–95 labour productivity in the Czech Republic has had an average negative rate). Even Polish shipbuilding has turned around, though with local difficulties, with the three largest shipyards exporting nearly $ 1bn in 1995 and boasting orders for 100 new ships, which make Poland the world’s fourth largest shipbuilder in terms of orders.

In spite of such restructuring, which is still to come in the other Visegrad economies except Hungary, labour unemployment has been falling from the peak of 17 per cent reached in 1993 down to 14.6 in 1995, also thanks to the acceleration of investment growth (from 2.8 and 2.9 per cent in 1992 and 1993 respectively to an average 10 per cent in 1994–96).

The private sector has continued to grow steadily, and is being boosted by the current implementation of the long awaited mass privatisation program, which involves the privatisation of 514 companies through the transfer of shares to fifteen National Investment Funds, whose certificates are given to investors in exchange for subsidised vouchers. The private sector contributed nearly 65% of GDP in 1996, through over 2 million private enterprises of which over 200,000 trade in the international market. By mid–1996 there are about 70 companies in the Warsaw Stock Exchange, with a market capitalisation of around $ 7 bn, corresponding to over 7% of GDP; a very active financial market operates for a variety of bills, notes and bonds.
Exports have been booming, by a quarter in 1994 and 40 per cent in 1995, in spite of a considerable real (and recently occasionally even nominal) appreciation of the zloty, though exporters are now beginning to feel its adverse effects on their competitiveness. The trade balance has been showing a deficit which, once border trade is taken into account (with border exports of the order of $ 5–6 billion a year) turned into a surplus in 1994–95. Even if there was a deficit, as there will probably be in 1996, external constraints to further growth have been eased by a dramatic increase in foreign investment, including financial investment. Over $ 7 billion have been invested in 1990–95, of which $ 2.7 bn in 1995 alone (an underestimate, as Poland records only investments in excess of $ 1 mn, i.e. by 362 companies at the end of 1995, out of over 24,000 registered companies with foreign participation). The US is the largest with one quarter of the total; Asian investors have also began to move in.

These trends are reflected in an extraordinary increase in the foreign reserves held by the National Bank of Poland (at over $15 bn equivalent to the value of over seven months imports, as against the IMF prudential norm of three to four months) and in the foreign assets of other financial institutions (another $7bn). These assets should enable Poland to meet without difficulty the forthcoming bunching of foreign debt repayments, though it should be possible to roll them over at least partly.

The soundness of Poland’s economic and financial position has been tested by its return to the international financial market. In mid–1995 Poland received its first ever sovereign debt ratings: Moody’s awarded Poland an investment grade Baa3, the highest ever received by a country that has undergone a Brady–style restructuring of foreign debt; IBCA gave Poland a BB+; Standard & Poor’s a BB, which was raised to BBB– in mid–April 1996. J P Morgan raised Poland’s first ever Eurobond issue of $ 250 million at 185 basis points over US Treasuries, i.e. better conditions than obtained by Hungary; other issues have followed since.

Overall, Poland is an outstanding success story. It is ready to join OECD in 1996 and is certain to be in the first batch of new EU
members from eastern Europe before the end of the century. One may say – if the double metaphor is allowed – that Poland has transformed itself “From cold turkey to soaring eagle”.

2. WHOSE SUCCESS?

When the catastrophic expectations of hostile observers were more and more falsified by such an outstanding performance, their reactions went through three stages. At first it was claimed that the state of the economy was not as good as it looked and in any case what was good was due to earlier policies taking effect with a lag. Then there was talk of “fool’s luck”, a Polish colloquial expression which here attributed success to international “konjunktura”. More recently there is a widespread recognition – at least among enlightened members of the opposition – that the good Polish economic performance has been the joint product of both pre- and post-September 1993 transformation and policies.

Attributing Polish economic success in the last three years to previous policies alone is peculiar: it implies economic policy lags implausibly long, unknown in economic history. Other transition economies who have enjoyed an identical start and the same external conditions have been considerably less successful. Clearly the new governments must be credited, in the first place, with continuing the fundamental processes of transition and stabilisation, in spite of new adverse conditions such as a lower degree of popular support for sustained austerity, hostile media, presidential obstructionism. The new governments must also be credited for their choice of policy instruments and their actual quantitative parameters – arguably more felicitous than that of their predecessors – and for the improvements and innovations which they introduced.

An organic and detailed package of medium/long term economic policies was provided in the “Strategy for Poland” programme, which I prepared with my team and launched shortly after my appointment
Minister of Finance and First Deputy Premier responsible for the economy in April 1994. Actually a first version of this “Strategy” was ready immediately after the elections, and had influenced government thinking from the very beginning. The “Strategy” was implemented with great commitment and determination, and a second major document, “Package 2000”, was launched in March 1996 extending its time horizon.

Leszek Balcerowicz and his team are rightly credited with designing and implementing the early stages of Polish stabilisation and transformation, and with righting many of his predecessors’ mistakes and their consequences. Equally, we can claim some credit for Polish consolidation, acceleration of growth and further progress, and for righting many of our predecessors’ mistakes and their consequences – including of course those of Balcerowicz. After all, we both served for over two years as Minister of Finance and Deputy Premier responsible for the economy, both provided continuity under different governments, both according to a programme which each of us had produced with his own equipe. If spontaneous developments, rather than design, are regarded as an explanation of Polish success surely they must have had a bigger weight under the relatively more “laissez faire, laissez passer” philosophy of the Balcerowicz Plan.

3. CONTINUITY

The new governments have unerringly continued to implement a number of fundamental commitments:

1) **Fiscal restraint**, which has actually been tightened and steadied (at under 3 per cent of GDP) with respect to the more erratic and tendentially less strict stance of previous governments.

2) **Monetary restraint**, in full respect of National Bank of Poland independence. This is to say that any excess monetary expansion with respect to stated intentions and targets has been
generated not by the monetisation of public sector deficit but by a
combination of external factors and NBP interest and exchange rate
policies (see below).

3) **Trade and price liberalisation.** The import surcharge
introduced by previous governments has been abolished with effect
from 1–1–1997; new temporary levies on agricultural products were
aimed only at partially offsetting the adverse effects of EU subsidised
exports on Polish producers. Otherwise Poland has continued its
integration into the European and world economy at an accelerated
pace, as witnessed by the much faster growth of foreign trade
turnover with respect to income, and by the achievement of zloty
convertibility according to IMF Article VIII standards. Poland’s
progress towards membership of OECD and the EU has continued
at as fast a pace as technically feasible (the slight delay in OECD
membership with respect to the Czech Republic and Hungary is
immaterial; it was due to specifically Polish problems such as those
of the shipbuilding industry or the land ownership regime inherited
from the old system).

4) **Further building of market institutions,** enhancing
competition, hardening budget constraints, promoting the mobility
and redeployment of resources; and in particular,

5) **Further privatisation on all tracks,** including the overdue
implementation of the mass privatisation programme, which had
been delayed under previous as well as the new governments initially
by both the technical and political problems of the approach
originally selected. This, unlike the Czechoslovak approach, placed
on the government complex and controversial procedural burdens,
such as setting up National Investment Funds, selecting Fund
managers, negotiating reward formulas, allocating enterprises. At
the end of 1995 the private sector contributed about 65 per cent of
GDP. The implementation of mass privatisation will involve a further
significant expansion, corresponding to an expected addition of the
order of $ 3 bn to the capitalisation of the Warsaw Stock Exchange.

6) **The continued deceleration of inflation,** to be achieved
not only through the instruments listed above, i.e. fiscal and monetary
restraint, and the promotion of domestic and international competition, but also through the negotiated containment of labour costs (see below).

4. Changes

At the same time, "Strategy for Poland” and “Package 2000” have included many significant changes with respect to the approach followed by previous governments. These changes are due partly to a different vision of the transformation, as a more participatory and more open-ended process; partly to different government preferences, attaching greater weight both to economic growth and to the social costs of stabilisation and transformation; partly simply to learning from previous mistakes, something which usually is, and has been, much more difficult for those who have committed them.

1) Interactive versus imperative transformation. The new approach can be labelled social democratic (with low case initials in order not to confuse the label with self-styled users of that label) versus the earlier liberal approach (some would say liberal fundamentalist). Social democratic does not mean etatist, as often suggested in Poland in public discussions; the association comes from the mistaken identification of macroeconomic and industrial policies with direct state interference with the economic life of individual enterprises – whether through subsidisation or fiscal pressure, access to credit or direct controls. This is not to say that such interference has already ended completely, but at any rate such is government policy. My Chief of Economic Advisors, Jerzy Hausner, indeed calls himself “anti-étatist”, though “not in the sense of being an enemy of an active role of the state in the economy: ... as Karl Polanyi demonstrated, an extreme liberal project leads in practice to far reaching state interference in the economy”.

In Hausner's words “Most important is the choice between an imperative and an interactive mode of transformation” (Gospodarka
i Przyszłość, April 1996, Jaki Ustroj?, p. 7). Hence the recognition of a plurality of market systems; the shift from a centrally planned to a participatory process of institution building, the deliberate construction of a market system in place of the passive expectation that it will establish itself once the government has destroyed the old system. The former approach is exemplified by Jeffrey Sachs’s belief that “markets spring up as soon as central planning bureaucrats vacate the field” (Poland’s jump to the market economy, MIT Press, Cambridge Mass, 1993, p. xii) and by what Hausner calls “transformation as victory” legitimising the desirability if “creative destruction” (see below on agriculture and industrial policy).

2) **Parity between private and state sector.** On the rebound from the old system, the early transition had deliberately grossly neglected and penalised the state sector, with discriminatory and therefore inefficient taxation not levied on the private sector. These were for instance the so-called “dividend”, a capital tax levied regardless of profitability and of re-investment requirements, and above all the excess wage tax (PPWW or popiwek) whose added function was that of enlisting employee support for privatisation in the hope of higher wages. By 1993 these taxes had already come under criticism, for instance by Finance Minister Jerzy Osiatynski, who however had not dismantled it. Popiwek was abolished only by the new governments, and the dividend was significantly reduced.

For the purpose of establishing parity between private and state enterprises, “Strategy for Poland” envisaged the commercialisation of state enterprises, i.e. their corporatisation, with transformation of entrepreneurial functions of employees organs into limited shareholdings of employees, the appointment of board of directors and the enhancement of managers’ functions, penalties and rewards. This “commercialisation” process was seen not as an alternative to privatisation, but as a preparation of state enterprises for either a more efficient and faster privatisation or a more efficient operation by the Treasury of those enterprises which were to remain in state hands. In the end the commercialisation law was vetoed by the former President but the approach is being continued. Of course there are still areas in which state enterprises are still in a position
of favour (for instance, getting away with substantial tax or social security payments arrears, as in the railways or the coal mines); however these are recognised anomalies which the government strives to overcome, not the result of deliberate government policy.

By the same token, there have been attempts at reorganisation, financial and capacity restructuring of enterprises and banks, in place of the earlier so-called “creative destruction” of the state sector and all that there was before, dear to the early promoters of transition (though in truth the financial restructuring of enterprises and banks implemented under the new governments had been initiated already before September 1993).

Occasionally enterprise and bank restructuring has followed the route of consolidation and mergers, which have been sometimes interpreted – wrongly – as a process threatening privatisation and competition. For instance, seven state-owned oil refineries and the main petrol distribution network have been merged recently into a holding company, in order precisely to raise efficiency and help the industry to stand up to western competition, and in view of prospective privatisation. The refineries and the distribution network will maintain their identities as separate companies and will begin to be privatised within a year, while the holding company will also be privatised after two years. Similarly, bank mergers have been regarded as a way not only to facilitate restructuring but actually to speed up their privatisation by dealing with a single larger unit.

3) **Industrial policy.** In 1991 the Minister for Industry Tadeusz Syryjczyk quipped that “the best policy is no industrial policy”. It may or may not be that the *least* industrial policy is best (to paraphrase President Jefferson, for whom the least government was also the best), but actually the least industrial policy or the least government possible and efficient may actually amount to quite a lot. No industrial policy simply means a residual industrial policy by default, implicit in other policy choices. Thus the industrial policy implicit in the governments of early transition consisted of unrestricted free trade, high interest rates and nominal credit targets amounting to the unintended squeeze of real credit (because of
underestimated inflation), grossly undervalued exchange rates rapidly appreciating in real terms, discriminatory penalisation of the state sector – a recipe for fast and deep recession, only partly offset by reliance on privatisation.

The kind of industrial policy that should be avoided – and was by and large avoided by the new governments – is one of direct or indirect favour or disfavour for individual enterprises, or of general loosening of budgetary constraints.

Otherwise, there is a great deal of scope for “an active role of the state in the economy” or indeed in industry: for instance promoting investment, especially in sectors characterised by price–elastic and income–elastic international demand, or by faster growing labour productivity; improving access to credit of small and medium size enterprises and generally favouring their formation and growth; encouraging innovation; promoting marketing; insuring exports through new institutions of export credit guarantee; introducing and protecting standards; reclaiming and protecting the environment. In “Strategy for Poland” such a role of the state is seen as strengthening a market economy and its growth, as in the experience of all fast growing economies, whether today or in a recent or distant past. The lesson of the “developmental state” success in the Pacific area is not lost in the “Strategy” approach.

4) Agricuulture. Like industry, in the course of early transition agriculture is also characterised by an adverse implicit policy, consisting of high – retroactive – interest rate on existing as well as new loans, drastic deterioration in rural input/output terms of trade, exposure to the competition of EC subsidised exports both in domestic and in traditional export markets, all resulting in a significant rural income fall relatively to urban levels (in place of the earlier policy of rural/urban parity). In Polish agriculture the destructive tendencies of the early transition governments manifest themselves in identifying modernisation with the destruction of the rural cooperative movement, as well as family farming, thus weakening the supply response of the whole sector.

After some temporary price support, fractional with respect to European CAP and provoked by the inroad of subsidised European
food in the Polish market, “Strategy for Poland” envisages greater expenditure on agriculture, and emphasis on multi-track growth of rural areas, which incidentally corresponds to the latest European Union “integrated rural policy”. These policies are linked both with regional development policies and with environmental protection.

Poland is characterised by an exceedingly large number of productive units below 2 hectares; recently some re-structuring has taken place, with the growth both of new medium-large size units and of new small but highly productive and specialised market gardening units.

5) Regional development promotion. In place of a regional policy of budgetary transfers, “Strategy for Poland” promotes regional growth through regional self-determination and a degree of financial autonomy. This approach mobilises local entrepreneurship and other resources, establishes local control over economic processes and, either way, is expected to raise economic efficiency and self-reliance. An example of this approach is the regional restructuring contract negotiated for Silesia.

These policies, incidentally, are also very close to the EU approach, which also promotes initiative from below, integrated approaches, as well as even deeper interventions of “regional development planning”.

6) A genuine labour market. Former indirect controls such as the excess wage tax (PPWW) were typical of what in the old system used to be called “indirect or parametric centralisation” (i.e. the grading of policy parameters so as to induce the same result that would obtain with direct controls). The ideal of early transition governments seemed to be a system of generalised markets for everything except labour. Following the new strategy these indirect controls were abolished. The continued need to contain labour costs, in order to promote international competitiveness and lower inflation, was satisfied in other ways, namely at the micro-level with the promotion of workers participation in enterprise results, and at the economy-wide level with a negotiating structure for both white and blue collar workers. The new Tri-partite Commission is to replace
the earlier direct confrontation between enterprises and workers, often directed against a government powerless to intervene in the private sector.

Such negotiating structure is reminiscent of former Labour Minister Jacek Kuron’s “enterprise pact” but goes much further, because it embraces entire sectors and the whole economy (and in any case Kuron’s initiative was not part of the early transition liberal design but a social–democratic appendage).

These labour market policies are also particularly close to European Union policy, which promotes partnership relations between labour and capital (Social Chapter, profit sharing, etc.).

Unfortunately this economy–wide negotiating mechanism has not yet been fully implemented whereas adverse phenomena have appeared, such as railway strikes, difficult to handle without the new structure in position.

7) Reform of social security and pension systems. The present social security system is far from self–financing and represents an unbearable burden on the state budget, while at the same time it raises labour costs by at least one third.

With 15 per cent of GDP, Poland already has one of the highest levels of public pensions expenditure in Europe. Without reform, further increases are projected which would immediately clash with the maintenance of fiscal restraint. Previous governments had not faced this problem; their attempts at income and pension cuts in the public sector were later declared unconstitutional by the Constitutional Court. In line with the “Strategy for Poland” principles, in 1995 the government presented a draft proposal for drastic reform moving from a pay–as–you–go system to a fully capitalised pension system. More precisely, the new pension system would consist of three–tiers:

– a basic pension available to all,

– a compulsory earnings–related contribution system, and

– voluntary contributions to pension funds.
This system should enhance the level of savings and the provision of funds for company investment. In addition it is planned to earmark a significant fraction of state assets, still to be privatised, for the endowment of additional funds which would invest their income in the purchase of government bonds, with a view to finance the transition to the new system.

A number of painful but necessary decisions, also from the viewpoint of overall fairness, involve the move to indexation to prices instead of wages, the increase of retiring age for women, a more stringent regulation of invalidity pensions, and the reduction of pensions granted in the past on the occasion of plant closures.

8) Reduction and redistribution of the tax burden. While sustaining fiscal discipline, government policy is aimed at reducing the share of public expenditure in GDP from the earlier 32–34 per cent to below 30 per cent.

In 1997 it is proposed to index tax thresholds for the three groups of personal income taxation, at the same time reducing the rates from 21, 33 and 45 per cent respectively to 20, 30 and 40 per cent. This should reduce the personal income tax burden by an absolute amount approaching 1 per cent of GDP. Tax rates reduction should encourage the surfacing of economic activities now submerged in the “grey economy”, which is another important element of the “Strategy for Poland”. The fairer contribution of the “grey economy” – which in 1994 was estimated to be adding an unrecorded 18–20 per cent to official GDP – should make possible the further reduction of the tax burden. There is a commitment not to introduce a capital gains tax at least until the year 2000, in the interest of capital accumulation and growth (see below).

Additional changes in tax structure introduced by the “Package 2000” (raising VAT on energy, rises in excises, etcetera) to match the parallel reductions in profit tax introduced in order to encourage investment (see below).

9) Promotion of investment and growth. Within a policy of fiscal restraint, “Strategy for Poland” promotes investment and growth directly, through investment switching in government
expenditures; and indirectly, through the tax regime, for instance through accelerated depreciation schemes for enterprises and profit tax reductions geared to reinvestment, and through incentives to housing investment for individuals (including restructuring of past housing debts, access to mortgages, a new Housing Fund, etcetera).

It is mainly through the acceleration of growth, as well as through standard active labour policies, that unemployment can be brought down further.

10) The reform of the Centre. A major element of “Strategy for Poland” is the reform of central state administration in directions that should fully reflect the transformation from a centrally planned economy with dominant state ownership to a market economy with dominant private ownership and enterprise. This involves the elimination of a number of central (such as the Central Office of Planning) or branch–oriented institutions, the overhauling of the management of a much smaller but more commercially oriented state enterprise sector, the decentralisation of central powers to the regional level. While this aspect of the new Strategy has been delayed with respect to the more urgent tasks related to economic stabilisation and consolidation, the reform of the centre is an integral part of the overall design and should soon be implemented with the Parliament’s approval of 11 legislative projects already in the pipeline.

11) Coordination with the National Bank of Poland. The policy followed by the new governments has been one of respect for central bank independence – in spite of the NBP Governor’s political involvement as a presidential candidate in the autumn of 1995 – but transparent debate on targets and instruments. In normal market economies there is a frequent though by no means universal support for Central Bank independence, in order to constrain government ability to raise employment through inflationary fiscal deficits and domestic currency devaluations. This involves a division of targets and instruments between Central Bank – restraining monetary expansion in order to achieve low inflation and supporting the domestic currency’s international strength – and government
aiming at employment targets through fiscal policy.

In the early transition there was considerable cooperation between the Ministry of Finance and the independent National Bank of Poland. Under the new governments there seems to have been a certain reversal of roles between the two. Namely, NBP appeared to be particularly concerned with supporting the international competitiveness of Polish exports – and therefore employment – through the steady crawling nominal devaluation of the zloty. At the same time NBP was seemingly oblivious to the inflationary impact of its rapidly growing reserves on monetary expansion. It therefore fell upon the government, and in particular the Ministry of Finance, to press for an anti-inflationary policy, through a lower rate of crawl accompanied by a lower interest rate. It is not clear whether in the last three years NBP reserves were rising due to trade surpluses caused by a still undervalued zloty or due to foreign capital inflows attracted by excessively high Polish interest rates (i.e. higher than needed to match foreign interest rates plus the risk of zloty nominal devaluation). Either way, however, the measures advocated by the Ministry of Finance would have reduced the rate of reserves acquisition by the NBP and their inflationary effects.

Such rapid accumulation of reserves was partly sterilised at great cost for NBP, a cost equivalent to the excess interest differential over zloty devaluation; such cost is revealed by NBP profit contributions to the state budget rapidly falling in 1995 and 1996 and being poised to reach actual losses. To the extent that additional reserves were not sterilised, they led to monetary expansion at a faster rate than originally targeted – and therefore higher inflation.

Arguably a lower rate of inflation could have been achieved by lower interest rates and a more stable exchange rate. Nevertheless, it was important that both considerations – inflation and unemployment – should at least be represented by different institutions, even within a somewhat uncommon attribution of roles between NBP and the Ministry of Finance. From May to the end of 1995 market forces brought about occasional nominal revaluation of the zloty and lower interest rates, thus bringing much closer the
position of the NBP and the Ministry of Finance, and laying the
foundations for renewed cooperation.

12) **Privatisation: revenue, governance, distribution.** Last
but most definitely not least, “Strategy for Poland” promotes
privatisation on all tracks. Past commitments to mass privatisation
have been honoured; the private sector has continued to grow much
faster than income. The new economic programme, however, has
placed greater emphasis on revenue–raising with respect to give–
away privatisation; on governance mechanisms (commercialisation
– see above) with respect to the purely nominal transfer of ownership;
on distribution effects – favouring old age pensioners and employees
(see above on the use of state assets to fund the pension reform).
Thus in 1995 “capital” privatisations involved only 26 firms,
compared to 48 firms in 1993 – a natural slow–down once the share
of privatised assets rises – but 1.7 bn zlotys were obtained by the
budget in sales revenue with respect to 200 mn zlotys in 1993.

Another feature of the new policy of privatisation is concern
for consensus at the enterprise level, and the associated powers of
initiative attributed to management and employees – a factor which
may sometimes slow down slightly the privatisation process but
certainly enhance its smooth implementation. Some speed should
be gained from the final resolution of pending re–privatisation claims,
unresolved in the early stages of Polish transition.

5. Plans, forecasts or commitments?

The “Strategy for Poland” and “Package 2000” documents
contain not only detailed positive propositions of economic policy
but also a set of macroeconomic projections for a variety of important
indicators, such as GDP, budgetary expenditure and revenue,
investment, inflation, wage guidelines, unemployment, imports and
exports, and so on. Package 2000 updates and extends to the end of
the century the projections originally given up to 1998 by “Strategy
for Poland”. The question arises of the precise nature of these projections. Are they to be regarded as an old-fashioned plan, or an indicative plan of French type, or simply a set of forecasts?

The documents in questions do not correspond to any of these alternative concepts. They are not an old-style “plan” because there are no detailed tasks and no obligation for economic subjects, whether private or public, whether enterprises or households. They are not an indicative plan because, again, they are not broken down by productive or functional sector, and because they are not the result of the iterative consultative process that would be needed to follow the French approach (there have been numerous policy consultations but they were aimed at building consensus, not at formulating an indicative plan). They are not a forecast of what is going to happen nor could it be because a considerable room for manoeuvre is left to government policy even within the general guidelines indicated in the documents; targets and instruments are not uniquely predetermined in a rigid way, invariant to endogenous and exogenous factors. Nor are these documents merely wishful thinking, because of a variety of policy instruments which are aimed at facilitating the desired course.

The documents are a statement of government multiannual commitments for the medium and the long term. These commitments are judged to be mutually consistent, feasible, commensurate with the range of instruments at the disposal at the government within the constraints of the open market economy and of democratic consensus. The most important of these instruments under direct government control, such as tax policy and the fiscal stance and major components of public expenditures, are given in detail. Other instruments are not specifically quantified because are not under the full control of the government or are subject to negotiations with groups or institutions; but as economic trends will unfold these other aspects of government policy will take shape – keeping the economy along a course as close as possible to the course mapped in the documents.

It is significant that the documents actually cover a period that goes beyond the time horizon of the present legislature and therefore
necessarily of the present government. This reflects the belief that any future government will be equally constrained by external factors and above all by the desire to maintain stabilisation, sustain economic growth, move fast towards accession to the European Union, enhance international credibility. Therefore any new government should be induced to continue along the same course simply because the policies recommended are sound and have worked – of course without prejudice for the kind of policy changes that are associated with the normal political alternations which intermittently occur in any democratic system.

6. Problem areas

1) **Holding a steady course.** The greatest difficulty of all is that of steering a steady course along the lines mapped by “Strategy for Poland” and “Package 2000”, overcoming the continuous and often exceedingly strong pressures exercised by all the various interest groups on government policy. Most economic observers fail to understand that both economic transformation and economic policy do not consist in the once–and–for–all adoption of measures – which is often the easiest part – but in their painful and watchful continuation in the face of mounting defensive moves by those groups which feel – rightly or wrongly – unfairly treated.

Paradoxically the very resumption and acceleration of growth – which should make it easier to satisfy rival claims – reawakens those pent–up aspirations and claims which at a time of deep crisis had been at least partly set aside or postponed. Electoral concerns, populist promises, uncooperative strategies, make it all that more difficult to steer a steady course. The latest expression of this kind of pressure is the proliferation of demands for the creation of Special Enterprise Zones (SSE) – a useful instrument for selective regional interventions which becomes all the more ineffective and costly with the growth of favoured areas.
2) **Pensions and Social Security reform.** Throughout OECD countries, and not only in Poland, the pension system's mounting liabilities appear to be a veritable time bomb; with the difference that in Poland such a bomb has a short fuse. No other countries – except for Italy perhaps – present such an adverse combination of aging population, a falling activity ratio, a high proportion of invalids and retirees, high unemployment, for an exceptionally high average pension relatively to the average wage. The reform of the system along the lines envisaged by "Strategy for Poland" is an absolute precondition of sustaining – let alone improving – the country's fiscal integrity.

Together with pensions, the reform of social security is also essential in order to prevent open-ended commitments which would easily jeopardise any attempt at containing public expenditure, and to ensure the targeting of public funds to the neediest recipients. For both pensions and social security reforms the achievement of a very broad social consensus is essential.

3) **Capacity restructuring.** It was always understood that restructuring would be the slowest among all transition tasks to be fully implemented. Poland's recent trends have been very encouraging (see above). The three sectors which still exhibit great difficulties are coal–mining, agriculture and banking.

In the coal industry it will be necessary to close down a number of mines, modernise the others, dismiss and possibly redeploy 80,000–100,000 workers, at a total cost which is anticipated to be of the order of $2–3 bn.

Agriculture is suffering from excessive fragmentation, the institutional shock of privatisation, inadequate and expensive access to credit, worsening terms of trade, hidden unemployment. Its reorganisation, modernisation and restructuring is one of the greatest challenges in Poland's preparation to join the European Community – whatever the evolution of the Common Agricultural Policy, whose application to Poland in its present form cannot possibly be taken for granted.
In the banking sector Poland is ahead of most transition economies thanks to a well executed and successful programme of financial restructuring of enterprises and banks, compared to the repeated (four) Hungarian attempts at bank recapitalisation, or the problematic experiences of countries that have relied on the alternative approach of "hospitalising" ailing enterprises. However the fragility of the financial system is both slow and expensive to remedy; while the very privatisation of banks runs up against their already excessive share in the stock exchange capitalisation.

4) **NBP.** Imagine an enterprise, especially in the state sector, that consistently sold its product at a price lower than that at which it purchases it; or a bank that consistently lent at an interest rate which was lower than that paid on deposits; or a central bank that openly borrowed foreign exchange at an interest cost in order simply to accumulate idle reserves. Undoubtedly there would be an instant and loud public outcry for the closure of such an enterprise or bank, or for the cessation of such uneconomic practices.

Yet NBP behaviour in 1994–96 corresponds – mutatis mutandis – precisely to this kind of behaviour, but gets away with it without losing face nor power simply because its effects are somewhat concealed by the veil of its combined interest and exchange rate policies. By offering to foreign investors a real interest rate equivalent to that of its competitors, in spite of the zloty appreciating in real terms with respect to nearly all other currencies by virtue of its initial gross undervaluation, NBP attracts foreign speculative investment which is converted into zlotys and invested at such attractive rates. In order to contain the corresponding monetary expansion, NBP borrows back from the public the zlotys thus put into circulation (i.e. it "sterilises" foreign investment), at a rate which in terms of dollars, when zloty devaluation is deducted, is lower than the interest rate which NBP earns on its own reserves invested in hard currencies financial assets.

For example, over the last year NBP has purchased dollars reserves on which it cannot have obtained more than 6–7 per cent interest. Since the US dollar exchange rate in terms of zlotys has
gone up by 3 per cent over the same period, NBP has obtained on those reserves at most 10 per cent in terms of zlotys. In order to restrain monetary growth, some of the zlotys released into the Polish economy through the purchase of those dollars are borrowed back by NBP, through the sale of either government bonds in its possession (thus giving up a yield of, say, 25 per cent) or issuing its own bonds (thus actually paying an interest rate of, say, 24 per cent). Either way, the cost of sterilisation of US dollars added to NBP reserves in the course of last year will have been of the order of several points over 10 per cent. The lower revenue or actual losses involved are difficult to calculate precisely because they depend on the currency composition of reserves, the timing of reserve acquisition and sterilisation, the time pattern of continuously changing exchange rates and interest rate differentials. But there can be no conceivable doubt that such revenue losses are massive, of an order of magnitude similar to that of entire productive sectors in need of restructuring.

Effectively, NBP funds the deficits of foreign governments at the cost of Polish tax–payers; it is a recurring cost for as long as the interest rate differential with other countries exceeds the rate of Polish devaluation. If NBP does not sterilise such inflows, money supply rises and causes inflation.

The inappropriateness of this policy may not be clear to the average Polish tax–payer, but is clearly revealed by four simple facts. i) EBRD has issued internationally zloty–indexed bonds at an interest rate significantly low – by at least 4–5 points – than the interest rate paid by NBP on its own bonds, indicating that there is room for reducing interest rates further. ii) In 1995–96 NBP has increased dramatically the extent of its own indebtedness through the issue of the bonds it uses to sterilise reserve acquisition. iii) In 1995–96 NBP has sharply reduced its profits – about 85–87 per cent of which are transferred annually to the state budget – and is poised to make actual losses in the near future. iv) Money supply has been exceeding NBP commitments by percentages of the order of the current rate of inflation, thus continuously fuelling its continuation: in 1995 money supply grew by 34.9 per cent instead of the postulated
22.8 per cent, while the budget deficit makes a falling and now negligible contribution to the expansion of the money supply (5.2 per cent in 1995, as opposed to 85 per cent contributed by non-sterilised NBP reserve acquisition).

NBP representatives have blamed the persistence of the public sector deficit for the high cost of sterilisation. Of course if there was a surplus in the state budget, and if such a surplus was large enough to offset the net acquisition of reserves of NBP, there would be no need for sterilisation and these costs would not be incurred. This however would imply total subordination of fiscal policy to the whims of the NBP governor – i.e. NBP dominance instead of mere independence.

Regardless of its independence, NBP should not fritter away the fruits of seigniorage in the costly pursuit of its own ambitions. At the very least it should have a hard budget constraint preventing it from incurring net losses.

Should NBP continue the present policy the government would have no choice but introduce countervailing fiscal measures. For instance, a tax could be introduced on financial capital inflows, at a rate that would confiscate the excess interest overpaid by NBP over and above the rate that would ensure the desired level of capital inflow. Alternatively, NBP should be held more strictly to the implementation of its own monetary targets, and instead of being given a limit to its maximum purchase of government bonds it should be given a limit to its sale of both government and its own bonds.

7. From shock to therapy, recovery and growth

In conclusion, since September 1993 the new coalition governments have continued to consolidate economic stabilisation through fiscal and monetary restraint; promote further price and trade liberalisation with a view to integrate more fully the Polish
economy into world trade and in particular the European Union; implement the further building of market institutions, and in particular pursue further privatisation on all tracks. The continuation of such policies, and that part of Polish economic success that can be attributed to them, should not be regarded as the natural consequence of their adoption in 1990, but the specific achievement of sustained and determinate efforts by all subsequent governments to date.

At the same time, post-1993 economic policy in Poland is characterised by a wide ranging strategy for the medium and long term, aiming at curing the adverse side-effects of the policies followed in the early transition, and at making further progress from stabilisation to consolidation, from recovery to sustained growth. The new policies were enshrined in two major policy documents – “Strategy for Poland” (September 1993, June 1994) and “Package 2000” (March 1996), widely discussed in public debates and approved by government and Parliament. Beside detailed instruments of economic policy, these documents contain a wide ranging set of major macrorconomic indicators up to the year 2000 – a government commitment backed by the full range of instruments at the government’s disposal, only partly deployed in the policy documents.

In the Polish early transition (1990–93) the positive moves subsequently continued by the new governments (1993–96) were accompanied by a number of highly debatable policies, arguably responsible for much of the recession and inflation of 1990–92. Thus, for instance, excessive initial devaluation of the zloty in 1990, with respect to any notion of international competitiveness, had prolonged inflationary repercussions. The excessive initial abatement of tariffs, partly remedied by a subsequent import surcharge, reversed the more desirable pattern of temporary moderate initial protection followed by later liberalisation (as in the CSFR). A large and unintended credit shock occurred in 1990, due to adopting as nominal anchors monetary aggregates selected on the basis of under-estimated inflation, then left unchanged when inflation turned out to be higher. The state sector was neglected and
penalised, a common practice known in transition literature as “state sector desertion”. Privatisation procedures neglected revenue raising potential and the requirements of corporate governance. Central administration, whose structure reflected the needs of the old system, was not reformed; indeed the entire transformation process exhibited a centralised, indeed imperative nature.

There is a widespread feeling, throughout Polish society, that much of the social cost of the early transition was unnecessary, or that specific policies followed in the earlier transition were not worth the specific benefits attached to them. The new policy documents seek to remedy and reverse these specific policies, without prejudice for the overall stabilisation and transition and indeed to their advantage. Hence the more participatory nature of the transformation process; the parity sought between private and public sector; the sectoral policies in industry and agriculture, and regional development policies, associated with the “developmental state” approach of the more successful emerging economies, without falling into etatist temptations; the introduction of participatory wage formulas and tri–partite negotiation procedures, in place of direct or parametric control on wages; pensions and social security reform; reduction and redistribution of the tax burden; renewed emphasis on the revenue–raising and corporate governance implications of privatisation; the reform of the Centre.

The two policy documents aim at de–fusing cumulative mechanisms (such as pensions and social security, or NBP exchange and interest policies) which otherwise would destroy the financial viability of the system, and at promoting actively pro–investment, pro–growth factors in public policy. Difficulties still need to be overcome, such as obtaining consensus over pensions reform, restructuring and down–sizing uneconomic activities, or just holding a steady course.

The soundness of the policy changes and innovations introduced by “Strategy for Poland” and “Package 2000” have been outlined above and are discussed in greater depth in the two documents and associated materials, which develop the intellectual arguments in their support. Ultimately however, figures speak louder than words:
the strongest arguments are the outstanding Polish economic performance in 1994–96, and the judgement of the international financial community backed by their lending and investment decisions.