ECONOMIC TRANSFORMATION IN POLAND: 1990-2000

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CERTIFICATE

This is to certify that the dissertation entitled **"ECONOMIC TRANSFORMATION IN POLAND - 1990-2000"**, submitted by **Ms. SAIREE CHAHAL** in partial fulfillment of the award of the degree of **Master of Philosophy** of Jawaharlal Nehru University, New Delhi has not been previously submitted for any other degree of this or any other university. We recommend that this dissertation be placed before examiners for evaluation.

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The guru who imparts knowledge to the ignorant is like a father. - Mahabharata

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I also extend my apologies for any errors or omissions, which are solely my responsibility.

Sairee Chahal

A sail is gliding in the torrent,
Enveloped in a bluish haze.
What does it seek 'mid breakers' foreign?
What did it leave in native bays?

The tempest roars, the sea is riven.
The mast gives in: it bends and creaks.
No, not by joy, this sail is driven,
And 'tis not joy it vainly seeks!

Beneath, the stream is deep and quiet:
Above, the clouds are soft as fleece...
Alas! It longs for storms and riot,
As if a storm could bring it peace.

M. Lermontov
1832

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Introduction

Poland came under the Soviet domination after the Second World War. As a result of this an authoritarian political system of a party-state type was established under the leadership of Polish United Workers Party (PUWP) and it was at this time that the system of private property was replaced by central planing and state ownership[1]. The economy under the central planning system made great strides initially owing to high rate of investment. However, a decline soon followed in the 1960's.

The entire 1970's were witness to great political upheavals. Protests in Gdansk in 1970 claimed Wladyslaw Gomulka, who was replaced by Edward Gierek, who aspired to improve the standard of living across the country[2]. This was to be done through foreign aid in terms of technology and finance. In 1971-78, national income grew at a phenomenal pace but the systemic inadequacies continued to dodge the economy. Soon Poland stood at the threshold of economic crisis with a massive burden of foreign debt.

In August 1980, a wave of strikes hit the country and for the first time an independent trade union called the Solidarity was established. Soon enough Solidarity gained the status of a full-fledged strong socio-political movement. Demands were placed before the government structures to reform the economic system and were met with tough resistance. In December 1981,

[1] Sharma, Deepak, "Restructuring from Command Economy to Market: A Study of Poland," in Jain, R.B, "*Command to Market Economy-Restructuring and Transformation*," (Deep Publications: New Delhi, 2000) p. 333.
[2] Ibid. p.335

General Wojciech Jaruzelski imposed martial law. Solidarity was first suspended and then declared illegal[3].

An economic reform package was launched in 1982, which was aimed at enhancing autonomy of state enterprises, restructuring the bureaucratic system and revitalize the allocation mechanism. However, this set of reforms failed to bring about the desired results.

In 1988, the Mieczyslaw Rakowski government introduced yet another reform package that was dominated by substantial economic liberalization, with respect to the private sector and foreign trade. Somehow, this was accompanied by growing wage pressure as a result of which inflation and shortages mounted. The program met with limited success[4].

The Solidarity achieved victory in the 1989 elections and a government was formed under the leadership of Tadeurz Mazowiecki. In 1989, the Solidarity government commenced a strategy to transform the economic situation.

More than ten years ago, Poland embarked on its journey towards the market economy, after carrying the historic legacy of Centrally Planned Economy (CPE) for more than five decades. It was perhaps the first centrally planned economy to undergo such radical economic reform and transformation. The transformation has been attributed to fundamental systemic change besides a whole range of acute economic urgency driving the

[3] World Bank, "*Poland: Transition to Market Economy,*" (Washington; International Bank of Reconstruction and Development, 1996).

[4] Jain, op. cit. 336.

reform process. The reform process was aimed at stabilizing the economy, promoting structural reforms and orienting the way towards a becoming a full-fledged market economy, which eventually sought to align with the European Union as a political-economic power, at par with the rest of the countries existing on the block. Poland's experience in terms of economic transition also provides valuable insight to the rest of the transition economies, particularly in Central and Eastern Europe.

Poland's experiment at economic metastasis has come to yield results, which have not hit the bull's eye but have scraped through enough to place the economy in a stability zone. Poland's Gross Domestic Product (GDP) was 20 percent larger in 1999 than in 1989.[5]

This dissertation is an attempt to briefly study, the ten years of economic transition and reforms in Poland, which is an offshoot of restructuring that swept entire Central and Eastern Europe in the early 1990's. The aim of the restructuring was to develop strong, independent and democratic political-economic-social systems, which would facilitate the development process.

Poland has been chosen as the area of study owing to the fact that it is a significantly large country in Central and Eastern Europe, with an equally prominent economy. It is a pioneer in field of political and economic transformation and supports evidence of attempted reforms at various stages in its history. Poland's transition from a planned economy to a market system

5 Balcerowicz, Leszek, "Poland's Transformation," *Finance and Development*, Volume 37, No. 3, 2000, p. 14.

began under extremely difficult conditions, which included high inflation, scarcity of consumer goods and production inefficiencies. The Polish economy entered the 1990s as the weakest economic power. It is setting foot into the new millennium with a fair chance of emerging the strongest[6]. The period from 1990-2000 has not only been overtly decisive for Poland in almost all spheres of the economy, these years also hold valuable insights and experiences from the desired transition.

The study is an analytical description of the Polish Economic Transformation Process. The study aims to map out the Polish Economic Transformation process, using available the primary and secondary sources, literature, economic indicators and data, so as to clearly illustrate the Polish model of economic transformation, which is the first successful transformation of a centrally planned economy to a market economy. It has also examined the inherited macroeconomic disequilibrium that called for tough stabilization measures. The study broadly provides a description of the ten years of the transition of the Polish economy. Within the economic transformation, it mainly deals with issues related to macroeconomic stabilization and privatization of the Polish economy. It also deals with the issues related to internal and external liberalization as well as its economic integration with the EU.

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[6] Embassy of Poland in India, *How to Trade with Poland in 2001*, (New Delhi: Commercial Office, Embassy of Poland in India, 2001).

The study deals with the socio-economic impact of the transformation on different sections of the society. These issues are however touched upon, whenever necessary.

This dissertation provides an overview of the Polish economic transformation. It has also provided the latest economic indicators, expert opinion and related programs as a significant input to gain insight into the topic.

The entire dissertation consists of four chapters and a concluding note. The first chapter "Polish Economy Before 1990: An Overview" provides an overview of Polish economy before 1990. It is an introduction to the functioning of the Polish model of the economy. It historically traces its development right after the World War II and map it till the 1990, which marks an absolutely new era in history of Polish economy.

The second chapter "Stabilization Program and Reform Measures" focusses on the notable 'Stabilization Program,' which ushered in the transformation process. This chapter also deals with various reform measures that came into effect and the proposed model of economic development. It also takes up major macro-economic issues, during 1990-2000 and assesses the outlook for the future.

The third chapter "Privatization in Poland" deals with the privatization process in Poland during the last ten years. It elaborates on various issues and policies associated with privatization. The desired targets and achieved results are also reflected upon in this chapter.

The last chapter "Economic Integration with the European Union and rest of the World" assesses Poland's move to integrate with the world economy and gain access to the European Union (EU). It also analyzes foreign trade, foreign direct investment, international institutional aid and Poland's trade policy regime.

Finally the conclusion evaluates the entire economic transition and the issues discussed in various chapters. It also attempts to conclude with a few significant insights gained after ten years of reforms. The outlook for the future is also discussed along with the possible economic development model for times to come.

Polish Economy Before 1990: An Overview

Introduction

Study of economic history of any given area or period stems from the need to ascertain and understand the roots of contemporary economic realms. If the country happens to be Poland, the task of examining becomes doubly consequential owing to the sheer complexity and unprecedented patterns of economic evolution.

In this chapter, an attempt has been made to chart out the ways and means adopted by Poland to facilitate economic development and assess the patterns of economic thinking that have been instrumental in shaping up the Polish economy. We will also try to gain an insight into the functioning of the earlier economic system of Poland. We will begin from the post-war era, when the task of rebuilding the development structures was gigantic and uphill, till the late 80's when a stark rethinking process had already been initiated to reform the economic orientation and approach. The aim is to present a broad picture of economic life of Poland before the 1990's, which is when the domineering set of post-Soviet changes began to emerge.

Post War Economy

Immediately after the Second World War, industrialization had to be resumed under difficult conditions, with serious destruction of capital, decimation of the intelligentsia and with factories that were left without any work force.

The predominant share of the large-scale industries was owned by the pre-war Polish state, German occupants, foreign owners and victims of German annihilation. The production process came to be fostered largely by the state in due course. However, in some cases, workers had reactivated the factories with immediate effect. The Provisional government had come to gain control of nationalized banks, capital assets owned by German occupants and absentee owners as early as 1944. The state had also come to establish control over heavy industries, a considerable share of light industry and transportation, communications and banks. The entire land holdings came to be redistributed during this time.

Prior to the initiation of the three-year plan, sectoral plans had been enumerated. The earliest one can be traced out to the Coal Plan of 1945. One of the most significant sectoral plans included one for financing investments for 1946, which proved valuable in due course and acted as an initiator for further development programs.

The Polish economy bore infinite losses in terms of property and people. Not only that it lost a major chunk of fixed capital, but also in terms of reserves, inventories, public and private property, budgetary and financial income. Over six million people lost their lives and more than 600,000 were unable to work owing to injuries and disabilities. The loss in terms of human capital also turned out to be immense.

However, the economy started soon enough to bounce back to pre-war levels. For example, by 1945, industrial production stood at about 70 percent of the 1939 level and by 1946, the same figure stood at about 94 percent of the 1939 level. From 1946 to 1947, industrial production witnessed an upsurge of about 37 percent. Albeit, agricultural production failed to reach even 50 percent of the 1939 levels. However, the per capita agricultural production stood at 67 percent of the pre-war level. A lot of food shortage was assuaged by foreign aid[1].

Three-Year Plan: 1947-49

In the Polish economic history, the three-year plan goes down as the period of reconstruction and recovery from the Second World War. This is also known as the period of establishment and augmentation of state control over the development process.

What came to be known as the Three-Year plan was in fact the post-war reconstruction plan drafted for the period 1946-49. It later got approved as the Three-Year plan for 1947-49. The plan basically attempted to forecast production, national income and the standard of living. It aimed to accentuate production levels, within the existing production apparatus and infrastructure levels. Perceptibly, no quest was made to change the production set-up or

[1] Feiwal, George, *Poland's Industrialization Policy: A Current Analysis*, (New York: Praeger Publishers, 1971) p.230.

modernize the methods. However, a long-term goal of building a larger than ever-before industrial set-up was stressed upon.

The Three-Year plan primarily aimed to raise the standard of living to the pre-war level. By 1949, the per capita food consumption was targeted to be 10 percent higher than the pre-war level. The consumption of industrial goods was steered at a level 20 percent higher than the pre-war level. A high level of investment growth, of 20 percent higher than the 1939 level was calculated. Budgetary credits, bank credits and private investments were targeted to achieve the investment levels.

By 1949, per capita consumption exceeded the pre-war level by 30 percent. Not only this, the consumption of material goods from personal incomes surmounted the previous comparative levels by 20 percent, notwithstanding, the fact largely underlined by economic historians that the population level had sloped as the result of the war and that there was a marked shift in borders, accompanied by migration in both directions.

By the end of 1949, Gross industrial production was supposed to touch PLZ 3.5 billion of the pre-war level. This was exceeded by PLZ 3.4 billion, an over-fulfillment of nearly 9 percent.

Following were the reasons cited for the success of the three-year plan.

1. The nationalization of the means of production in the industry promoted full utilization of the productive machinery. Despite of the war damage, production rose, owing to the use of productive apparatus that lay idle during the inter-war period primarily due to deficiency of demand and

specific policy of foreign monopolies that prevailed in the country at that time. This meant a rise in employment.

2. Nationalization permitted transfer of resources among enterprises and sped up the production process. Concentration of investment funds in main areas of production added up to the benefit.
3. Nationalization restricted the consumption of luxuries from profit.
4. Poland gained from the post war shift of frontiers. The areas ceded to the USSR were less industrialized and enterprises in the Western areas had higher technical level.
5. Reconstruction got a boost from foreign aid. Coal made up 70-80 percent of exports during the plan[2].

However, it should be noted that extensive growth factors were instrumental in reconstruction of production and consumption. Reconstruction of the economy did not aim towards transforming the structure of production. It still managed to utilize the available productive apparatus and increased the share of industry in national income.

Table 1.1
Growth Indexes of Gross Output and National Income (1938-49)

	1938	1946	1947	1948	1949
Growth output of industry	100	70	90	124	148
Growth output of agriculture	100	47	60	75	86
National Income (NI)	100	69	89	109	128
Percentage growth of NI	--	--	46	32	28

Source: Feiwal, George, *Problems in Polish Economic Planning: Continuity, Change and Prospects*, (New York: Praeger Publishers, 1971) p.233.

[2]. Ibid. p. 235.

Polish Economy in the 1950's

The need to initiate economic reforms in Poland was stressed publicly for the first time during the early 1950's, after problems of economic growth cropped up. Demise of Stalin in the neighboring USSR added to the effect and in 1955, a congress of economists demanded a correction of the "economic model."[3]

The Polish economy in the 1950's was brought up on the principle of the socialist economies, largely borrowed from the USSR. The country came to rely heavily on the USSR model of growth in its orientation and methods. This model of development was also known as the ' Socialist model of economic development'. The emphasis was laid on heavy industrialization and it was ensured that in order to maintain the growth rate. The pace of growth of heavy industries or the producer goods industries outpaces the consumer goods industries.

The factors that led to Poland taking to this model of development can be briefly summed up as the following[4]:

1. The USSR was the only socialist country that had come to achieve a relatively high degree of industrialization in the post war and post revolution period of 1940's. The assumption that the same pattern of economic development could spell out bright results lead to Poland embarking on this very model.

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[3] Mizsei, Kalman, "A Comparative Analysis of Hungarian and Polish Economic Reform Theory," *Yearbook of East European Economics*, Band 12, No. 1, 1987, p. 42.

[4] Feiwal op. cit p. 70.

2. Owing to the nature of economic and political assistance Poland got from USSR, the propensity to seek development models from USSR came along the way into the Polish plans. Poland relied heavily on USSR to gain technical support, and raw materials. In turn Poland was also meeting the needs of USSR and other socialist countries.

3. The USSR model of economic development came to be established as the "universal pattern" of development largely due to the fact that it embraced it first and was an under developed nation doing so, making it even more easier for countries like Poland to adopt a similar pattern.

The Polish economy relied resolutely on heavy industrialization during the 1950's. The priority was spelt out for producer goods industry and heavy industries. Centralization of economic development and reliance on system of government planning came to be widely attributed to the entire development process during this period. This was keenly evident in the Six-Year Plan (SYP) of 1950-1955.

The SYP was drafted in 1948. The targets of SYP were revised subsequently in 1950 and then were followed by an increase in target in 1951 and 1952 respectively.

The prime objective of the SYP was to develop branches of production serving the investment process by the means of considerable investment outlays. A substantial increase in per capita consumption and an increase in real wage were also stipulated. The SYP envisaged a high rate of growth of output in all branches of production, with greater stress on increase of producer goods. Other targets included collectivization of agriculture and limitation of capitalist constituents.

While the Three-Year Plan (TYP) was primarily indicative or forecasting in nature, the SYP assumed the characteristics of an imperative or command plan. There existed a distinct move towards self-sufficiency.

The SYP was extremely ambitious and targeted extremely unrealistic and unprecedented growth rates. Investment targets were directed at never before levels, and were supposed to increase by 130-150 percent and employment level was supposed to surpass the 1949 level by 27 percent, which by any given standards represented an extremely escalated objective. There was a continuous revision and up-gradation of the plan targets and according to the last version, by 1955 investments were to rise by 140 percent, in comparison to the 1949 level. Employment was to rise by 60 percent. National income was to grow by 112 percent and agricultural output by 50 percent. The real wages and the standard of living were postulated to accent by 40 percent and 60 percent respectively.

At that point of time, the Polish economy possessed several distinct advantages for acceleration of economic growth rate. They included:

1. Development was not taking place after a period of economic stagnation but was following the rapid economic growth that took place in post war economy. Rapid growth rates had been registered in the previous plan. The conviction behind the SYP was to take advantage of economic growth

process and continue the success of reconstruction period by rapidly moving the industrialization plans.

2. Poland had a relatively developed infrastructure.
3. Territorial consolidation had taken place during the reconstruction period. In the first SYP, Poland still had reserves of under-utilized production capacities. According to estimates, they were under-utilized by 55-60 percent[5].

However, the Polish economy was not free of some absolute and relative disadvantages as well. Some of which included:

1. Low skill set level amongst the labor force and lack of key management and technical expertise.
2. Lack of new productive machinery and use of old methods and apparatus, which often did not add to the productivity levels.
3. The post-war Poland had deteriorating international relations and a dilapidated foreign policy, which blocked the flow of technology and organizational know-how from other countries, particularly the western ones.
4. The focus of production capacities shifted to building up of defense potential and hampered the SYP being on course.

A comparison of the post SYP levels and the destined targets is a bit tricky, primarily in view of changing production structures and price distortions. Constant prices seemed inadequate for comparing dynamics of

[5] Feiwal, op.cit. 15.

production. Also the plan did not stipulate clearly the magnitudes to which its indexes referred. For example, it was not clear whether the index of industrial production referred to gross output or final output. Indexes for consumption and living standards were often used interchangeably.

The plan targets were however under-fulfilled. Investment and employment managed to scrape through but the national income and consumption levels remained much below planned figures. Interestingly, despite the under fulfillment of investment plan, accumulation targets were exceeded by 10 percent.

TABLE 1.2
Six Year Plan Fulfillment
(1949=100)

	SYP Target	Fulfillment
National Income	212	175
Investment	240	236
Employment	160	156
Per Capita Consumption	150-160	130-144
Real Wages	140	104-113
Industrial Output	258	270
Agricultural Output	150	113

Source: Same as Table 1.1, p. 238.

First Five Year Plan 1956-60

The first Five-Year Plan (FYP) was transitional in nature, between the first and second wave of post war industrialization. It was realized that the realization of the targets of the plan was of special significance in order to ensure a more even development in the subsequent times to come. It also aimed to equalize existing disproportions and particularly the ones related to rate of growth and standards of living. The prime aim of the economic policy during the first FYP was to continue process of industrialization in a lower gear and to assuage the dislocations that arose during the SYP between the growth of output and increase in consumption. A reform of the system of functioning of the economy and especially the incentive system was pre-assumed to be an integral part of the FYP.

The period of 1956-57 was basically devoted to tying up of loose ends, which were left after the SYP. It included completion of investments started during the SYP. Nevertheless, by 1958-59 a wave of new investments, stronger than the originally planned were started, keeping in view economic policy for the second FYP. Owing to this factor, 1958-59 has also been called the beginning of a second stage of Polish industrialization. Almost an entire decade (1959-68) was spent on overcoming barriers that had become apparent during the SYP and after that. The industry had to shoulder the task of promoting itself besides, boosting exports, consumption, agricultural production and technical progression.

Theoretically, the 1956-60 FYP was devoted to completing SYP targets and to adapting the economy to succeeding FYPs. Shortages and the elan of the SYP conditioned the course of the first FYP. However, its fulfillment was smoother and featured a relatively large growth in real income. It also recorded lesser deviations from planned targets.

There were two distinct phases detected for the 1956-60 FYP.

- The period 1956-57 featured an accelerated rate of increase in personal incomes. This was in excess of the rate of growth and levels ascertained for the entire plan. It was also a period of consolidation, when attempts were made to repair the most unpleasantly conspicuous damages caused by the strains of the SYP.
- The period 1959-60 featured a relatively slower pace of rise in consumption, in comparison to that of production. It was marked by an increase in investment in the industry, whose levels had remained stagnant for a few years now. This was a renewed investment cycle, where driven by demographic cycles and unfinished production cycles. It also carried a fear of being outdistanced by other socialist nations. A whole lot of investment was redirected to the heavy industries. This was meant to reinvigorate those branches, whose production has slackened during 1956-58. The aim was also to catch up with industrial growth and output rates of USSR and Czechoslovakia. In fact, the turnaround in the economic policy of the second phase demonstrated that cause of continuing rise of living standard had lost out. There existed a set of lobbyists, who criticized rise in standard of living, which they believed was done at the expense of 'required capital formation'. They opined that Poland's economic future would suffer, if this was continued.

Second Five Year Plan 1961-65

The 1961-65 FYP was part of the envisaged plan to match the ranks of highly industrialized nations. During the SYP the main source of growth of output and national income was a rapid rise in employment in the industry and construction. During the 1956-60 FYP, a relatively high rate of growth of national income was registered, coupled with sluggish pace of increase in outlays. This was perhaps owing to the investment projects undertaken in preceding years. The new agrarian policy, under which the agricultural co-operatives were disbanded, helped in liberating repressed reserves. During the early 1960's, the freedom to choose direction of investment and rate of growth was considerably circumscribed. The economy faced a lot of challenges. Some of them are as follows:

1. In 1961-65, production reserves were depleted. The planners could no longer depend on the reserves playing a huge role as growth propellers, as was the case in 1956-60. Somehow, planners overlooked this indigence and planned, viewing 1956-60's resources as inexhaustible.
2. The initial FYP instructions envisaged a 50 percent rise in gross industrial output, a 20 percent increase in agricultural output and almost a 40 percent rise in national income. All these rates were below the performance of the preceding FYP and they had to be achieved with a considerably higher rate of investment.
3. The raw materials and power base had to be developed. The growing needs of the processing industry had to be met with imports from

developing countries, the ones endowed with rich minerals. The issue of supply of raw materials for processing industries had to be solved. Over 32 percent of the outlays in industry were earmarked to development of fuels and energy.

4. New jobs had to be created. A rise in population of productive age was expected after 1962. After the demographic dip in the previous period, owing to the war losses, the post war generation was expected to join the workforce by 1963 and the demographic peak was expected to continue into the mid-70s.
5. Rapid technical progress was required and renewal and modernization of the productive apparatus was constantly required to keep pace with the world standards.
6. The second FYP expected balance of payments crisis. The earlier period has witnessed a certain inflow of long-term credits. Also keeping in view the negative balance of payments, the economy had to develop and restructure exports rapidly.

An overtly optimistic attitude was one of the biggest follies of the second FYP and its architects. They overestimated the possibilities on all fronts. Not only did the plan lack reserves in key areas, like agriculture and foreign trade but also banked on undisclosed reserves and potential sources without providing the required instruments to elicit them.

TABLE 1.3
Polish Economic Growth Cycle

1950-52	1953-56	1957-59	1960-63	1964-67	1968-71	1972-75	1976-80	1981-85
9.8	9.1	5.4	7.1	3.7	9.8	4.9	-6.5	4.9

Source: Kolodko, W, "From Recession to Growth in Post-Communist Economies: Expectations versus Reality," *Communist and Post Communist Studies*, Volume 26, No. 2, June 1993, pp. 123.

Third Five Year Plan 1966-70

At the time of the preparation of the third FYP, the planners were confronted with a specific set of issues, especially in the backdrop of a rising economic population. On one hand, the overall population numbers were not rising and on the other there was a marked rise of 10 percent in the economically active population.[6]

Although throughout the post World War II Poland had been facing difficulty in the sphere of foreign trade, during the 1966-70 period, equalizing the balance of payment crisis emerged as an acute problem.

Therefore, curbing imports and boosting exports seemed to be an integral part of the third FYP. However, the planners were aware of the fact that such a move could be detrimental for the standard of living.

A set of proposals by Michal Kalecki advocated creation of labor intensive jobs, coupled with reduction in material and capital-intensity.

In June 1964, the primary goals of the third FYP were adopted, which included[7]:

[6] Feiwal, op. cit. 333.
[7] Ibid. 334.

1. Further industrialization of the Polish economy, with the help of scientific-technical approach and determining the most effective investment variants.
2. Increasing the agricultural production and development of the sector.
3. Development of the domestic raw material base as this was an area, which had reflected negatively on the growth patterns during the earlier plans.
4. Improvement of the foreign trade by increasing exports and developing structure and profitability.
5. Increasing the output-efficiency levels and reducing raw materials costs. Stringent quality control was also emphasized.
6. Maintaining equilibrium between urban and rural standard of living.
7. Gradual creation of reserves for foreign currency, grain, raw materials as a safeguard to the fluctuations and perturbations in the economy.
8. The target of achieving a national income growth of 30 percent, industrial output by 45 percent, total consumption by 27 percent, investment expenditure by 38 percent, labor productivity by 4-4.5 percent and foreign trade turnover by 40 percent was laid out[8].

The third FYP came to be understood as a more cautious and effective plan, owing to the previous failures and difficulties. Since the plan assumed relatively cautious targets for industrial output, productivity, income and agriculture, plan targets were broadly satisfactory and reached more realistic levels.

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[8] Ibid 335-336.

During this period, national income grew approximately at the 1965 rate, ranging between 7.7 percent to 6.6 percent. The agricultural performance exceeded the prescribed targets and aided in further realizing the planned levels. Although, several investment plans were delayed, industrial production reached the desired target. Employment and wages outpaced industrial growth and proved to be a daunting task for the economic planners but smooth agricultural and industrial growth came proved helpful in bailing out the situation[9].

Economic Development During the 1970's

The reform debates in the 1960-70's was marked by an arousal in public interest over economic conditions, owing to critical campaigns in the press. However, a lack of a continuous and authentic reform debate and subsequent action ensured that no critical reform mechanism came to the fore. In 1973, the Szydlak Committee for reforms was dissolved. It was preceded by an anti-Semitic campaign developed in the wake of political tension, which gravely weakened the intellectual continuity to the reform process.[10] The 1970's were a period of economic decline in Poland. A set of reforms was introduced in 1973, under the 1971-75 five-year plan. A declining economic performance was the prime reason behind this move, which was fuelled by a declining labor force and lack of good technology.[11]

[9] Ibid. 364.
[10] Mizsei, op. cit. p.44.
[11] Wanless and Hare, "Polish and Hungarian Economic Reforms- A Comparison," *Soviet Studies*, Volume 33, No. 4, October 1981, p. 491.

The 1971-75 plan envisaged a shift towards more capital intensive growth through higher productivity and a rate of accumulation, initially financed by an increasing foreign debt. This move, however, led to a deterioration of Poland's economic position after 1973, particularly the inflationary pressure and external position[12]. Interestingly, National Income grew fairly well, at a rate of 10 percent per annum, which led to a shift in basic economic proportions. Living standards continued to rise and real wages grew by 7 percent as compared to the previous figure of 2 percent.

This although, led to a rise in living standards but the market was a sellers' market. The legendary shortages in the Polish markets, specially the meat shortages, attracted the attention the world over.

Foreign trade rose at a rapid pace, faster than national income. The foreign trade growth rate jumped from 9 percent p.a. from the 1966-70 plan to 13 percent during 1971-75 [13]. There was a marked shift in the direction of trade, which rose from being one-third of the total share to the almost half of the entire pie. This was complimented by a need to earn convertible currency. However, expansion in trade was accompanied by deterioration in the trade balance, which rose from a virtual balance in 1970 to a mounting balance of PLZ 7.5 billion in 1975.[14]

This era is also known for its historic increase in retail prices by the Gomulka government, which was announced on December 13, 1970. It was

[12] Ibid.p.492.
[13] Wanless, op. cit. 32.
[14] Wanless and Hare, op. cit. p.492.

aimed at moping up excess purchasing power and rationing foodstuff by purse. However, the move hit the low-income groups, which were already reeling under the impact of employment problems and wage freezes. This put into motion powerful resistance against the increasing extraction of surplus product.[15] The price hike spelled the end of the Gomulka regime. Gierek came to power. He was faced with a revolting population and economic stagnation. Price rise move was frozen and purchase of agricultural products was increased substantially.

Gierek undertook an ambitious program of capital accumulation, modernization based on technology import from the west and consumption growth. External finance was supposed to provide for increased investment and consumption under the plan. Labor productivity was scheduled to rise as the workers would have modern machines and equipment and increased material incentives were supposed to increase productivity. The industry was expected to become internationally competitive and higher exports were expected to help in repayment of foreign loans [16]. The plan turned out to be a debacle owing to faulty execution and adverse domestic and international conditions.

By 1974-75, investments grew at a phenomenal 35 percent and the socialist bias of accumulation tendency proved true. Investments were over-fulfilled and foreign debt rose massively. The end of the decade witnessed an

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[15] Feiwal, G.R, "A Socialist Model of Economic Development: The Polish and Bulgarian Experiences," *World Development,* Volume 9, No. 9110, 1981 p. 942.

[16] Nuti, Domenico, "Poland: Socialist Renewal and Economic Collapse" *New Left Review*, No.13, p. 24.

economic squeeze and a huge number of large unfinished projects. Investment patterns proved to be unsuccessful and over-concentration on metallurgy, steel, oil-based chemicals and heavy industries proved to be enormous liabilities [17]. The international oil crisis and the recession in the world economy accentuated the problems. Poland still had to rely on traditional exports like coal and food. Interest rates rose and petrodollar recycling encouraged more borrowing. Natural factors like frost, flood and snow added to the crisis. Economic decline and glaring failure eroded the credibility of the Gierek government.

Polish Economy in the 1980's

The dynamics of economic development and reform in Poland are an extension of the crisis phenomenon that the Polish economy underwent during the late 1970's and early 1980's. The economy continued to suffer for about a decade or so with low growth rates, sliding investment rate, stagnant consumption, permanent domestic disequilibrium, ever-increasing inflation rate, low propensity for technological and organizational innovations, low flexibility of production capacities, poor competitiveness in international markets and lastly the ever-surging foreign debt.

The adjustment programme and stabilization policies to reform the Polish economy after the crisis in 1980's aimed to provide an integrated approach to the existing economic crisis and lay out ground rules for growth and reform in future. In fact, this very period in Polish economic history is

[17] Ibid. 25-26.

viewed as the time of the most acute crisis. Notably, at the same time the efforts to sort out the economic problems and prepare a foreground for reform were initiated with maximum effort.

The exigency in Poland during the 80's has been dubbed broadly on three planes by Grzegorz Kolodko, during his study on Poland with the World Institute for Development Economics Research (WIDER), Helsinki. This includes Systemic, Structural and Political. The initial sign of crisis struck in form of *systemic crisis,* which was in fact a deep crisis in the operation of the national economy. The second type of economic crisis was observed as a crisis of the prevailing economic structures or broadly known as *structural crisis.* The next crisis phenomena had a strong impact on the economic policy. This was referred to as the *policy crisis,* basically implying that the ways in which the policies responded to the socio-economic challenges were inadequate.

The first visibly significant and radical systemic reform can be traced back to 1981-82. These included introduction of market relations, monetization of the economy, appreciating the role of the banking and financial system, withdrawal of the system of centralised planning and introduction of indicative strategic planning. Amongst other measures, introduction of company level initiative, promotion of workers' self-management and reinforcement of grass-root initiatives also formed a crucial part of the initial reform package. Democratization of political-economic relations also figured in the scheme of reform process, owing to the presence of an overtly consequential relation between the two.

The need for economic reform in Poland had been apparent for a significantly long time. The earlier attempts at reform did not suffice to solve the problem. Reforms initiated in 1956-58 and the WOG reforms (reforms of the large industrial units) in 1972-73 proved to be notable economic reform failures in the Polish economic history.

Table 1.4

Poland's Foreign Trade: 1971-1987
(previous year -100)

Indicator		1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
1	Import	113.8	122.1	122.6	114.2	105.0	110.3	100.4	101.5	98.8	98.1	83.1	86.3	105.2	108.6	107.9	104.9	104.5
2	Socialist countries	110.3	110.1	112.7	111.1	97.9	107.8	112.3	104.0	101.7	102.4	93.7	94.4	104.4	109.2	104.6	109.4	100.4
3	Other countries	102.7	146.6	137.8	119.2	112.2	111.4	89.1	98.0	95.5	92.8	68.5	75.8	106.6	107.4	113.4	98.1	110.7
4	Export	106.5	115.2	111.0	112.8	108.3	105.4	108.8	105.7	106.8	95.8	81.0	108.7	110.3	109.5	101.3	104.9	104.8
5	Social countries	106.9	115.9	112.0	116.0	109.6	99.7	110.6	107.5	109.6	90.5	83.0	116.6	108.3	110.0	108.1	107.6	102.8
6	Other countries	104.9	114.8	110.9	105.9	105.8	112.3	104.0	102.9	102.1	105.0	77.9	100.9	112.4	109.0	93.5	101.4	107.1
7	Index of import prices	98.2	99.6	108.8	116.9	112.0	100.4	105.5	103.8	108.0	109.5	108.9	161.5	105.3	114.7	122.0	117.1	140.8
8	Index of export prices	102.4	101.4	105.7	116.4	115.6	102.4	103.1	103.8	105.3	107.7	108.5	160.0	101.1	113.1	125.0	119.3	146.0
9	Terms of trade	104.3	101.8	97.1	99.5	103.2	102.0	97.7	100.0	97.5	98.4	99.6	99.1	96.0	98.6	102.5	101.9	103.7
10	Net National Income	107.9	110.3	111.0	110.6	108.9	107.1	105.7	104.0	99.0	95.7	88.8	95.2	106.0	105.5	103.3	104.8	101.8

Source: Kolodko, Grzegorz, *Reform, Stabilization Policies and Economic Adjustment in Poland*, World Institute for Development Economic Research, United Nations University, 1989. p.76.

The crisis during the late 1970's and early 1980's proved to be one of the severest peacetime economic declines for Poland. In 1982 the distributed net national income (NNI) per capita had fallen to 72.5 percent of the 1978 level. Investment and consumption fell to 55 percent and 88.7 percent respectively of their 1978 levels. Recession had begun to embrace the entire economy and all its sectors and the magnitude differed from sector to sector. Attempts to withhold the crisis and reform the economy using 'conventional' stabilizing instruments and planned economy measures proved absolutely futile. Centrally imposed reduction in investment outlays, paralleled by a shift in favor of consumer industries and those producing agricultural means of production and social infrastructure and services were amongst a few control measures. However, these measures were too meager to control the dramatic and immense disequilibrium that had crept in to the economic system. Notably, 1982 happened to be the last year of growth before the onset of further crisis.

Table 1.5
Main Economic Indicators in Poland, 1987

Indicator	1982=100	1978=100
Net National Income	123.3	98.8
National Income Distributed	122.8	89.1
Investment	143.5	55.0
Consumption	122.1	108.7
Industrial Output	126.6	109.6
Export	134.5	121.1
Import	135.1	93.9

Source: Polish Statistical Yearbook 1988, Warsaw, p. 62,65,143,240.

A wave of strikes hit Poland in the summer of 1980, which came to be interpreted as a protest of consumers dissatisfied with living conditions and workers trying to fight poor management and dismal working conditions. Analysts also viewed it as citizens' protest about the way that they were governed. These three factors later proved to be deciding the course and intensity of reform as well as provided the assumptions to carry policy and institutional support.

Two divergent, yet significant views emerged during 1980-81 on future course of action to solve the impending crisis.

On one hand there was a faction proposing to postpone any reform or remedy until 'better times' and advocated waiting till situation improved in due course. This group suggested that any forceful, radical stabilising and reformatory action be put on hold, until the economy recovered its capacity for economic growth. This was held on the assumption that the erstwhile system, coupled with some changes in economic policy will be sufficient to come to normal economic growth rate.

Another point of view, which sprang up upheld the immediate need for systemic reform. The group adhered to the view that in order to bring about fundamental changes for the better and to eliminate the destabilizing phenomena radical reforms and stringent approach had to be taken. This view eventually came to be accepted, owing to the fact that it got overwhelming support from the Polish United Workers' Party and the Solidarity Union.

The Polish economic reform package launched in 1982 is assumed to be the first of its kind, aimed at systemic reform and economic stabilization. The package was supposed to have had a three-plane structure. The first one included a set of legislative acts providing the legal framework and guarantees for economic reforms. The second concerned plans and economic programs adopted several months later, which were aimed at short-term stabilization and medium-term adjustment. The third plane was made up of policy decisions made within the framework outlined by the former two.[18]

The legal regulations introducing economic reform were conferred the highest rank, implying that they were the Parliamentary acts. It was primarily an attempt to guarantee support to the reform process from the highest legislative body in the nation. This represented some progress from the past and a proof of durability of the reform process.

First in the package of reformatory acts were the laws on state firms and workers' self-management. Socio-economic planning, prices and banking came next. The law on workers' self-management came to be adopted as early as September 1981. The other laws on banking and prices were adopted in February 1982, under the Polish Martial Law. "These five legal acts provided the institutional cornerstone, a 'Constitution' of Polish economic reform"[19].

[18] Kolodko, Grzegorz, *Reform, Stabilization Policies and Economic Adjustment in Poland*, Working Paper for Development Economic Research, (Helsinki: World Institute of Development Economics Research, 1988) p.9.
[19] Ibid. p. 11.

Table 1.6:
Rate of Inflation in Poland
(1980-1987)

Indices	1980	1981	1982	1983	1984	1985	1986	1987	1980-87 (Average)	1987 (1979-100)
Consumer goods (total) of which:	9.4	21.2	100.8	22.1	15.0	15.1	17.7	25.7	28.4	636.6
Commodities	9.6	22.1	106.8	21.0	14.7	14.0	17.5	24.4	28.8	640.0
Services	8.2	15.3	62.9	31.5	17.2	22.6	19.4	33.9	26.4	613.9
Food	12.8	22.5	136.3	11.9	16.8	14.9	14.6	22.0	31.5	685.6
Alcoholic Beverages	5.7	47.6	97.9	42.5	5.8	3.9	17.3	28.2	31.1	727.3
Non-Food	8.5	13.1	85.4	22.5	16.1	16.7	20.1	25.5	26.0	569.2

Source: Kolodko, Grzegorz, *Reform, Stabilization Policies and Economic Adjustment in Poland*, World Institute for Development Economic Research, United Nations University, 1989.p. 26.

The market orientation of the economic and financial systems, co-existing with non-directive, predominantly strategic, central planning were the fundamental features, which were created by the above mentioned framework by legislative bodies. The idea was to replace bureaucratic regulation, typical of the earlier periods by market regulation to an extent and partly by macro-economic planning. Enterprise autonomy, reflecting managers' and staffs' right to take decisions on investment, supply, production, sales, profits, distribution of profits and foreign operations accompanied the reform set. Central intervention into enterprise management was to be restricted to what was contained in legal acts.

The workers' self-management was another 'Constitutional' feature of the new economic model. It essentially aimed to illustrate company's staff's right to influence the fundamental decisions concerning profits and distribution, whilst remaining within the framework of the existing system and regulations. This kind of self-management also drew attention to the right to participate in the making of firms' strategic decisions, particularly with regard to investment, lasting co-operative arrangements, specialisation in export production etc. The entire move sought to eliminate the hegemony of bureaucratic structures and also that of the party structures. It meant to actualise real socialisation of the ownership of the means of production.

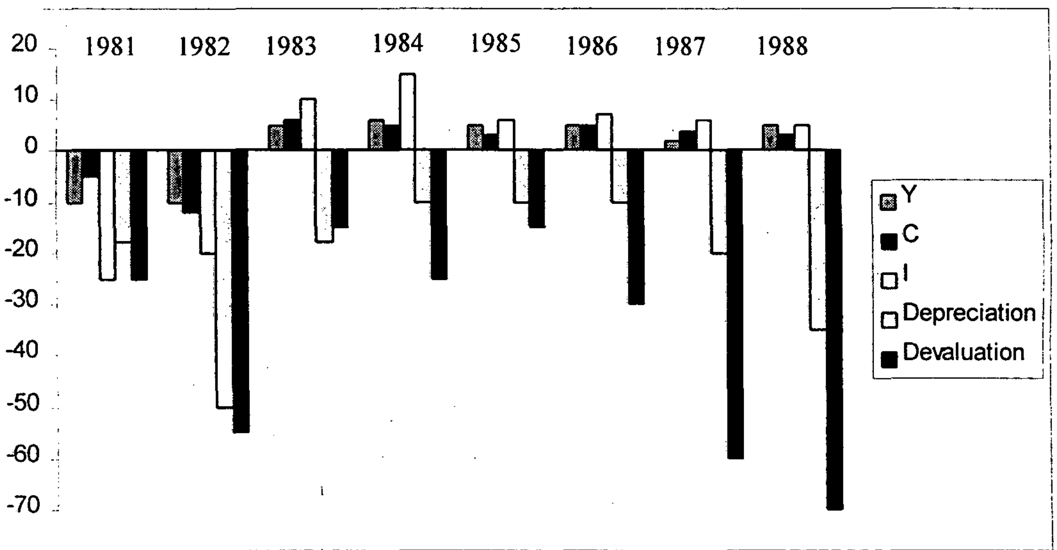
Self-financing was the third basic feature of the new programme. The objective was to induce budget constraints, which meant that a firm could spend only as much on its various goals as it could generate from its economic operations. Primarily this principle was premised on the attempt to harden the budget constraints, so as to necessitate better economic performance from the firms.

This system is also referred to as "Triple S"(owing to the fact that in Polish language, the words, autonomy, self-management, and self-financing start with an 'S'.

However, this system was subjected to a great deal of scrutiny and met with limited acceptance, owing to aberration in the success rate. A high degree of doubt prevailed over the success of co-existing market mechanism and self-management. Lack of conditions for operation of self-management coupled with absence of independent market mechanism added to and greatened the apprehensions.

Figure 1.1

Economic Growth and Money in Poland (1981-1988)



Source: Kolodko, Grzegorz, *Reform, Stabilization Policies and Economic Adjustment in Poland,* World Institute for Development Economic Research, United Nations University, 1989.p.69.

System Of Prices

In a bid to reform the Polish economy, attempts were made to bring about effective changes in the system of prices too. These reforms were downright stark, in comparison with the earlier attempts at price reforms. However, if one took, market economy standards as the benchmark, these efforts appeared grossly inadequate.

Let us have a broad look at the changes in the price system, to gain a clearer picture.

In February 1982, three price categories; *state, negotiable* and *regulated* were introduced. The state prices descended from the old system. The negotiable prices represented an attempt to reach transitional solutions and kept in mind the economy of shortages. The regulated prices were a vanguard of the new system.

The state prices were applicable to staple consumer goods and means of production. Initially in 1982, they were slightly in excess of 50 percent of the value of total supply, then became lower though there were temporary increases in this share. The list of these prices was prepared by the Parliament, on an annual basis, while a Ministry set and monitored their levels. Earlier it was the Price Office and the Finance Ministry, which set them in accordance to the government policies. A whole range of goods under the state prices were subsidised. Prices for agricultural products were set by a formula, referred to as *productive* and *redistributive* formula. The idea behind using this formula was to ensure profitability of agricultural production and maintain an adequate income level for rural population. However, the state prices system included only those agricultural products, which are essential for production costs and cost of living. The law also devised a system, where prices for industrial supplies had to be co-related with the world market prices. It is usually done by calculating the transaction prices, which at a given exchange rate, reflect current market prices in the domestic economy. Also the assumption that exchange rate should be set at a level, which would ensure the profitability of 80 percent of all exports, was held strongly. The prices of the major industrial supplies are bound to change, in accordance with the fluctuations in the world market.

The second set of prices – the negotiable prices were shaped depending on the market supply and demand affiliation. In other economies like Hungary and China, these prices, were also called the *free prices.* However, they were termed as negotiable owing to the accent laid on negotiations between the buyers and the sellers.

Characteristically these prices were neither equilibrium prices nor negotiable. The producers were still satisfied with the predetermined profit margin and did not raise prices, as required by the demand proportions. This was due to the inadvertent political pressure and public scrutiny, which deemed as 'unfair' and 'unjustified'. The practice of 'justifying' price rise, owing to rising costs and other factors still held a strong footing in the economic cycle. Another factor that weakened the negotiable price mechanism, was the weak position of the buyers and monopolistic position of the producers' extending itself as a typical characteristic feature of shortage economy.

The regulated prices were set on the basis of actual production costs plus a fixed margin. Given deep disequilibrium, these prices were accepted in the market. There was no incentive to cut down production costs and the records prove checking inflation seemed to be the most obvious reason to introduce this pricing mechanism. However, economists differed on the credibility of this mechanism and an array of opinions emerged on the topic. We shall restrict ourselves to delve into those, owing to the paucity of available expanse, in terms of focus and time.

Changes in the Planning System

Paralleling the change in price system, new direction was envisioned with regard to the steerage of the macro-economic processes in medium and long term.

The Law on Socio-economic Planning was devoted to such issues and was perhaps the only programme to draw less criticism from all lots, including economists, academicians, and politicians. It accented on the major market-oriented shift in the system of economic control and the long-assumed abandonment of the command type economic management. The law on planning officially approved the market orientation of the Polish economic reform. Under it, planning was primarily indicative and focussed on strategic goals. The regulation of concurrent economic affairs was left to market regulation. Areas for direct administrative instruments were scant and clearly defined. The law also stipulated the institution of government orders placed with autonomous companies.

It was on the assumption that the order will be given the highest bidder and the material distribution system will help boost this system. Keeping in view the significant supply constraints, government orders were quite often a guarantee of foreign exchange, scarce materials and were deemed indispensable in production. This greatly contributed to the failure of government orders as new planning instruments, which were designed to shape the structure of output by non-administrative means. Since everything started to come under the "important and urgent category", the concept itself lost its immediate effective relevance.

Far reaching socialisation of planning was another feature of this innovated planning system. This was done after the directive-type methods were abandoned. This problem was immense in terms of its dimension and covered a broader area, because it attempted to truly socialise the economy, this time on a macro-economic scale.

The socialization phenomenon was reflected in the fact that the planning authority had to submit alternative variants of long-term plans to the Parliament and the general public. This procedure was put into practice on two occasions, at the time of the preparation of the 1983-85 plan and during the 1986-90 plan. The idea of presenting these plans was to present different socio-economic development scenarios to the general public. At the time of proposing these plans, three variants of growth rate were proposed, optimistic, pessimistic and moderate. For example, for the 1983-85 plan, Net National Income (NNI) growth rate was pegged at 11, 16 and 18 percent respectively. Ultimately, the moderate rate was chosen for serving as a basis of preparation of the entire three-year plan and the supplemental stabilisation programmes. The NNI growth rate between 1983-85 was 15.7 percent, which was very close to the moderate estimate. The 1983-85 programme of economic growth and recovery is considered to be one of the most ambitious plans in post-war Poland, especially in backdrop of the serious crisis that the country was undergoing. This programme assumed that three years was a sufficient time to introduce economic reforms and bring qualitative changes.

However, this programme proved to be a shock for the masses. Average prices doubled overnight and were higher in case of staple products. Although, saving deposits were automatically compensated by an additional 20 percent rise in value, despite the regular interest rate. The real value of households' monetary assets suffered a major decline. The price reform resulted in a fall of 25 percent in average real wages.

Table 1.7

Growth of Foreign Debt in Convertible Currencies 1971-1987

(in billion USD)

Year	Balance of Foreign Trade	Gross Debt for End of Year	Net Debt for end of Year	Interests Paid	Amount of Capital Installments
1971	+0.1	1.3	0.8	0.1	0.3
1972	-0.3	1.7	.	0.1	0.3
1973	-1.3	3.1	.	0.1	0.4
1974	-2.1	5.3	.	0.3	0.6
1975	-2.7	8.4	7.4	0.5	0.9
1976	-2.9	12.1	.	0.7	1.2
1977	-2.2	15.4	13.5	0.9	1.9
1978	-2.0	18.5	17.0	1.2	3.1
1979	-1.7	21.9	21.5	1.7	4.4
1980	-1.0	25.0	24.4	2.5	5.6
1981	-0.1	25.5	24.7	2.3	1.4
1982	+1.4	25.2	24.2	1.9	0.4
1983	+1.4	26.4	25.2	1.6	0.5
1984	+1.5	26.8	25.5	1.3	0.4
1985	+1.1	29.3	28.1	1.0	0.9
1986	+1.1	33.5	32.4	1.2	0.8
1987	+1.1	39.2	37.9	1.0	0.8

Source: Kolodko, Grzegorz, *Reform, Stabilization Policies and Economic Adjustment in Poland*, World Institute for Development Economic Research, United Nations University, 1989.p.85.

Institutional Changes

The economic stabilisation programme of the 1980's incorporated significant changes in the institutional sector. Regulation in the financial sector was deemed as particularly absolute. The banking sector gained independence from the Ministry of Finance. Far reaching changes could be observed in the policies related to company taxation, wage funds and similar issues. Nevertheless, this did not lead to any significant decline in the tax burden imposed on the companies neither did it add to the stabilisation effect on a whole. Decentralisation of investment projects was perhaps the most crucial change that took place, especially in relation to the financing of investment projects. The central allocation of investment funds amounted to a sheer 20 percent in the 1987-88 period.

Considerable transformation was also brought about in the institutional field in central and non-central levels. The enterprises' unions, which were yet another intermediate link, were eliminated. These were bodies, which were grouped together on basis of administrative principles and were vertically integrated. In due course they had come to serve as specific socialist monopolies, owing to the lack of any form of active competition. The reform process, facilitated liquidation of such organisations and companies had started to group themselves into voluntary associations.

Overhauling of the massive state structures was another momentous step in terms of institutional changes, instigated at that point of time. Elimination of branch ministries, particularly those dealing with the industry and enhancement of the role of functional ministries besides a host of decisions in a similar perspective added to the transformation in the institutional sector. The functional ministries included finance, foreign, labour, social affairs and the National Bank of Poland.

Agriculture is another key area, where vital steps were undertaken during the reform process. Private farmers were offered constitutional guarantees of durability. It is important to note that private farming held a great deal of significance in Poland, than in any other socialist country, owing to the fact that private farmers held 76.5 percent of the agricultural land and contributed 69.1 percent of the entire agricultural output. It also generated notable employment opportunities, providing livelihood to 22.5 percent of the total workforce.

Legal recognition of providing equal economic status to all forms of ownership, where the state constituted about 80 percent of NNI and the private sector gave 20 percent came to be heralded as a key move in terms of direction and orientation.

The principle behind the entire reform movement was not to merely achieve short-term stabilisation, but to instill more durable changes and devise a mechanism, which would provide long-range structural changes.

Table 1.8:

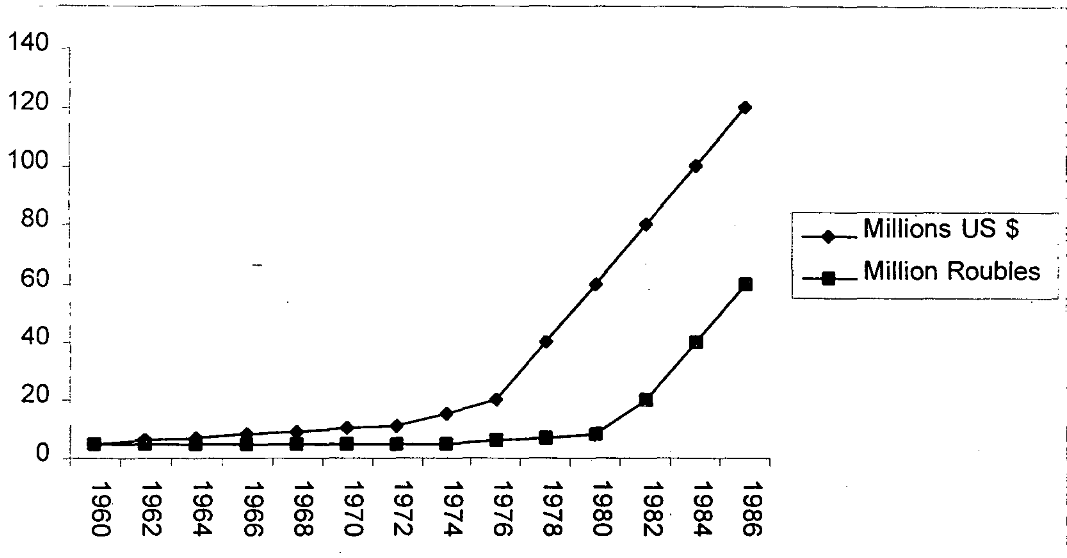
Structure and Rate of Growth of Investment: 1971-1990

(five years periods, in %)

	1971-75	1976-80	1981-85	1986-90 (plan)	Increase 1986-90/1981-85
Energy	9.0	8.9	10.7	12.2	42
Metallurgy	5.4	5.6	1.8	2.8	89
Engineering	9.6	9.2	6.4	7.0	36
Chemical	4.2	4.2	2.8	3.5	53
Light Industry	3.1	1.7	1.3	1.6	48
Food Industry	4.4	3.3	3.5	4.1	44
Other Industry	5.3	4.2	2.5	3.3	66
Agriculture & Forestry	15.0	16.7	19.0	17.3	13
Transportation	10.5	8.7	6.9	7.3	30
Other Mat. Prod. & Serv.	11.1	12.1	12.0	11.0	14
Total Material Prod.	77.6	74.7	66.8	70.0	30
Housing and Local Services	16.5	19.9	25.6	21.3	3
Education	1.8	1.5	2.4	2.9	51
Health	1.2	1.3	2.5	2.7	32
Other Non-Material serv.	3.0	2.7	2.7	3.2	44
Total Non-Material serv.	22.4	25.3	33.2	30.0	12
Total	100.0	100.0	100.0	100.0	24

Source: Same as table 1.6, p. 77

Figure 1.2
Polish Foreign Debt (1960-1987)



Source: www.paiz.gov.pl/1 12/tab/87.html

Table 1.9
Depreciation and Devaluation of Zloty (1981-1988)

		1981	1982	1983	1984	1985	1986	1987	1988
1	Depreciation	17.5	51.1	17.6	12.9	13.1	15.0	20.5	37.5
2	Devaluation	23.7	55.0	13.8	28.3	17.2	33.6	59.7	61.6

Source: www.imf.org/external/np/speeches/2001/010601a.htm

Impact of the Reforms

The shift brought about by this set of reforms was immense and changes with regard to control over the national economy were incisive. One of the evident ones being the approach taken in relation to budget constraints. Undoubtedly, the budget constraints affecting the enterprises were significantly hardened. Still, the mechanism to finance firms had loopholes and failed to contain fully the liquidity issue with majority of the firms. The state budget constraints seemed hardly changeable and continued to reflect essentially the benefits they received from 'soft' financing, i.e. continuance to depend on the phenomenon of justifying social needs, rather then working on the system of economic logic.

In August 1982, the Polish economy recovered its potential for economic growth[20]. For the first time production registered an up trend. The NNI increased by an impressive 15.7 percent between 1983-85, growing by an annual rate of 5 percent. Investment grew by 29 percent, thereby recording a yearly growth rate of 9.6 percent. Consumption also swelled by 12.2 percent, in tune with other parameters. It recorded a rise of 4.6 percent annually. These growth figures in a standard economic environment would have been deemed to be exceptional. However, owing to a set of phenomena, which accompanied economic growth, they were not-accorded outstanding status. The growth was considered to be only average because of the following reasons.

[20] Ibid. p. 33.

1. It was a phenomenon of reconstruction, after a catastrophic economic collapse. This was peculiar in case of distributed per capita NNI. It had fallen by 12.3 percent in 1982, implying that by 1985, not even one economic indicator had reached pre-crisis level and by 1987, it still stood below this level.
2. The structural changes during this period were still inadequate and when viewed in light of world economic standards, they seemed to be minuscule.
3. A whole lot of positive effects of the reform process were an offset of inflation that accompanied them, although the rate of inflation gradually declined.

Table1.10

Economic Growth in Poland: 1983-1988
(previous year - 100)

Indication	1983	1984	1985	1986	1987	1988
Net national Income	106.0	105.6	103.4	104.9	101.7	103.8
National Income Distributed	105.6	105.0	103.8	105.0	101.6	103.3
Investment	109.5	112.3	104.9	105.9	105.1	104.1
Consumption	105.8	104.4	102.9	104.8	102.9	102.9
Industrial Output	106.6	105.6	104.4	103.4	103.5	104.0
Export	110.3	109.5	101.3	104.9	104.8	105.5
Import	105.5	108.6	107.9	104.9	104.5	104.0

Source: Statistical Yearbook 1988, Warsaw p. 62, 65,143, 240.

Second Stage Reforms of the 1980's

The 10th Party Congress, held in 1986 formulated the programme for implementation of the second stage of the economic reforms. Another conjecture called the *Programme for Money Consolidation* (Programme 1987) was worked out.

The first hypothesis worked out a programme in the sphere of systemic change and the second one created a new stabilisation programme intended mostly to curb inflation, which was galloping at an uncontrollable rate. Shortages had become very much acute at this point and planned indices concerning price and wage increase in 1986-87 had been exceeded by almost 50 percent. The draft of both these documents were ready by spring 1987 and were submitted in line with the practice of consultation, negotiations and public discussions. The new programme was inferred to design measures, which were to 'enhance the role of money'. This programme being a continuation of the earlier one, aimed to extend and deepen the scope and accelerate the pace at which market relations were introduced into the economy. It also sought to preserve the role of long-term planning. The programme was evaluated by the World Bank and was deemed as the *farthest-reaching intention of the market-oriented economic reform* in socialist nations. It also sought to ensure equal rights for all forms of ownership in the economy.

In 1988, government brought out another project called the *Law on Entrepreneurship* to the Parliament. It specified the principles, on which economic activity was to be carried out and intended to relax the remaining bureaucratic, economic and political limitations.

Setting up of legal conditions for creation and growth of a capital market was another element of the second stage reform process. The underlying assumption to initiate such a move was that no efficient market mechanism could evolve without a capital and money market.

Therefore, opportunities were created to issue securities. So far they could be only bought by the state companies and applied to bonds issued by companies. This was regarded as a modest attempt to introduce capital market and initiated experimentation in this field.

The capital market in Poland was still coming into being and sought great deal of attention owing to the very nature of the experiment of moving from a Centrally Planned Economy (CPE) to a market-oriented system, which was unprecedented in history. It was in fact the nature of transition or the trial-run of market techniques, into a CPE, which more often than not produced off-track results.

The initial steps in reform of the banking system were taken in 1982, when the National Bank of Poland, also called the Monobank, credited firms and household sectors and remained a central bank as well. Paramount changes were introduced in May 1987, when a network of nine commercial banks was introduced. These banks were set up in areas, which constituted nearly 80 percent of the banking operations run by the National Bank of Poland.

This stage of economic reforms led to the opening of the Polish economy to the rest of the world. This was backed up by certain systemic changes as well as some restructuring and policy manoeuvres. The exchange rate, law on joint ventures and the right to retain a certain proportion of foreign exchange earnings are some areas, which deserve special mention. Undoubtedly, higher availability of foreign capital would go a long way in contributing to the stabilisation process and speed up economic growth in long term. This was perhaps, why the second stage provided for a broader reception to foreign capital.

Accession to the World Bank (WB) and the International Monetary Fund (IMF) in 1986 was a significant moment for the reform and stabilisation process. The access had been denied for a long time, primarily, due to political reasons. There were sanctions imposed on Poland by the United States, following the declaration of Martial Law in 1981. Both these bodies made a positive appraisal of the programme for implementation of the second stage of reforms. They extended their offer to assist in investment projects and were ready to provide extensive financial assistance.

Figure1.3

Economic Growth and Inflation in Poland (1981-1988)

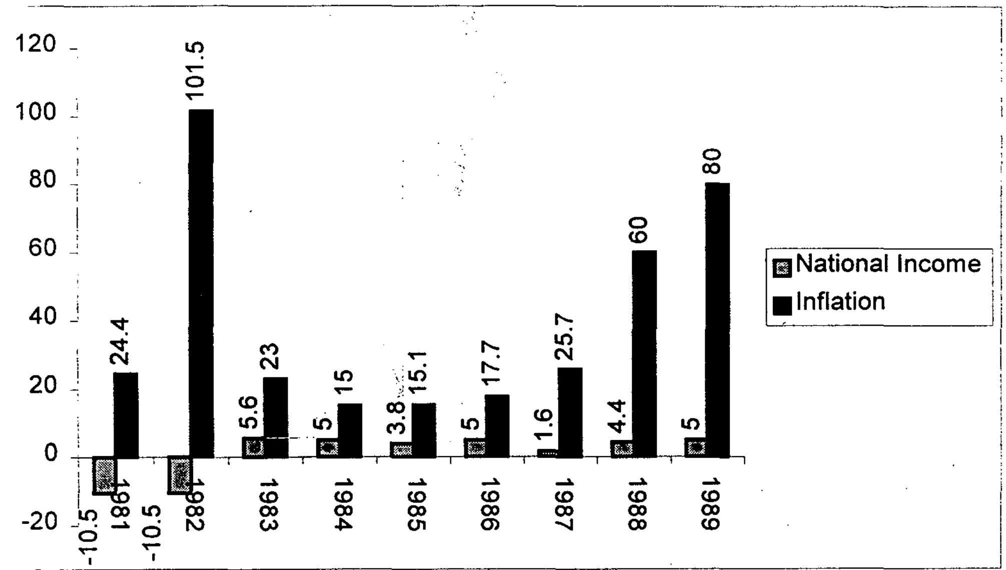


Table 1.11

Deficit in Foreign Trade 1970-1987
(In Roubles)

	1970-75	1976-79	1980	1981	1982	1983	1984	1985	1986	Total 1970-86
In millions of roubles	368	666	763	1611	578	614	668	715	501	6484
In % of NNI			0.9	2.3	0.8	0.7	0.7	0.5	0.5	

Source: Kolodko, Grzegorz, *Reform, Stabilization Policies and Economic Adjustment in Poland*, World Institute for Development Economic Research, United Nations University, 1989.p. 97, 88.

Stabilization Program and Reform Measures

Introduction

Poland under its Solidarity led coalition from 1989 was the first ex-communist state in East-Central Europe to adopt a radical economic reform programme, which is often called the "Balcerowicz plan". The then Finance Minister, Leszek Balcerowicz advocated "Shock treatment" a rapid, but painful transition to the market economy, expecting a sharp recession but calculating that the costs of the plan would be more than compensated, by its medium and long term benefits. Balcerowicz argued that Poland had no option but radical market reforms and he also dismissed the suggestion of a Polish "third way" between socialism and capitalism.

Another argument that prevailed was that gradual reform would rather result in stagnation instead of escaping the costs of transition. Introduced in 1990, 'shock treatment' included an end to central planning, abolition of state subsides, liberalization of prices and privatization. Balcerowicz opined at that time:

"The point here is not the success of the government, but the chances for the success of all the people. Although this will require tremendous effort and

often also sacrifices, particularly at the beginning of the path of reforms that we intend to carry on[1]*."*

Pre-Stabilization Scenario

The first non-communist government was formed in Poland in 1989 and the economy was in a state of severe and rapidly growing economic imbalance. The budget deficit had reached 7-9 percent of the GDP[2]. An overdeveloped raw material and energy sector existed and high domestic and external indebtedness marked the state of affairs[3]. Hyperinflation, mismanagement and lack of development capital were the order of the day. By 1990, GDP had declined by 12 percent, and a sharp decline in living standards was witnessed, as inflation reached alarming levels. Public sector workers and social security recipients suffered.

As we have seen in the last chapter, the Polish economy was in a state of constant disequilibrium ever since the adoption of the system of planned economy. The 1980's witnessed an accentuated macro-economic crisis and the reform process of 1982 was unable to halt them. There existed an evident discrepancy between the structure of the economy and the needs of consumption and production throughout the 1980's. Distorted wage and price patterns added to the deterioration process besides the relation of savings and

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[1] Summary of World Broadcasts, EE/0577/ C1/2, 3 October 1989.

[2] Ebrill, Liam, Ajai Chopra, Charalambos Christofides, Paul Mylones, Inci Otker and Gerd Schwartz, "*Poland: The Path to a Market Economy,*" (Geneva: International Monetary Fund, 1994) p. 2.

[3] Camdessus, Michael, "Achievements and Prospects after Ten Years of Transition," http.www.org/external/np/speeches/1999/121099.htm. p. 4.

supply of goods and services getting intensified. The 1987 set of reforms acted as a catalyst to the crisis and aimed at faster growth of prices than wages so as to reduce the existing imbalance without carrying out the essential systemic changes and eliminating the fundamental cause of disequilibrium in the Polish economy. However, wage pressure in this case accentuated the situation.[4]

The spate of strikes in 1988, produced a economic and political disturbance. An increased money supply failed to bring about the desired effect. Avoiding fundamental political and economic changes further lead to an inflationary spiral of wages and prices, which reached sky-high[5]. This situation intensified in 1989, when wage pressure from the enterprises and branches in the strongest positions caused wage-price equation to regress. Albeit more slowly than wages, prices rose swiftly, leading to mounting pressure from the suffering sides such as employees in budget-financed sector (transport, communications, education, health). Soon Poland faced uncontrolled budget deficit and hyperinflation[6]. Although rising budget deficit and mounting inflation is not an unusual phenomenon for any given economy and implementation of stabilization measures generally follows them.

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[4] Beksiak, Janusz, Tomasz Gruszecki, Aleksander Jedraszczyk, Jan Winiecki *Outline of a Programme for Stabilization and Systemic Changes* (London: CRCE, 1989) p.22.
[5] Kemme David, *Economic Reform in Poland: The Aftermath of Martial Law 1981-88*, (Greenwich, Connecticut: JAI Press, 1991) p.18.
[6] Beksiak, Janusz, Tomasz Gruszecki, Aleksander Jedraszczyk, Jan Winiecki, op.cit, p.23.

Poland's case has been particularly tricky owing to inherited economic structures and restrictions prevalent within the system. Presence of Soviet-type economy along with the rigidity caused by the existence of a range of monopolies, which restricted the possibility of supply reaction to change in prices, the absence of institutional structure facilitating the functioning of goods and factor markets. Inability to solve ownership issues added to the economic woes. Moreover, severe price distortion of relative prices resulting from the isolation of the Polish economy from the worlds market proved to be difficult problems, when it came to seeking an end to endemic economic misery. It was anticipated that it will be harder and will take longer to achieve a fall in the rate of increase in prices and their eventual stabilization. Permanent results in form of economic growth and rise in real income for the population was also expected to come into effect only after a series of stabilization measures were implemented.

Transformation Measures

Transition from planned to a market economy entails several crucial decisions into prime economic areas. These steps were accented as the following[7].

1. Liberalization of prices and decentralization, involving operational autonomy for the enterprises, legalizing parallel unofficial markets,

[7] Sharma, Deepak, "Restructuring from Command Economy to Market: A Study of Poland," in Jain, R.B, "*Command to Market Economy-Restructuring and Transformation*," (Deep Publications: New Delhi, 2000) p. 333.

establishing uniform exchange rates, decentralization of state organization and freedom of market entry.

2. Stabilization policies, which would *inter alia* involve creation of competitive banking system. This is helpful in ensuring positive real interest rates, tax-based income policies and low-inflation monetary policies.

3. Privatization, involving apportionment of big firms and unbundling of assets, establishing venture capital markets, regulation of natural monopolies and privatization of real estate.

4. Liberalizing the economy to encourage import competition, export liberalization and removal of restrictions on foreign direct investment.

5. Introduction of competition policies, which would primarily consist of creation of deregulation, demonopolization, creation of competitive financial markets, retraining of labor to combat redundancies.

6. Transformation of Factor Market, Labor, Land, Capital and Credit[8]

7. Attitudinal changes such as acceptance of private property rights, income differentials and wealth disparities, and promotion of performance oriented pay.

[8] Johnson, Gale, "*Economies in Transition: Hungary and Poland, FAO Economic and Social Development Paper*", (Rome: FAO Social and Economic Department, 1997) p.6.

8. Change in role of government, shift from direct production player to system enabler and policy creator.

Economists like Stanley Fischer and Jeffrey Sachs advocated standard prescription for ex-socialist countries to proceed to a market economy. It included as fast as possible macroeconomic stabilization, liberalization of domestic trade and prices, current account convertibility, privatization and the creation of a social safety net, while simultaneously creating the legal framework for a market economy. A striking degree of unanimity was observed among economists on this set of advice to the reforming nations.[9]

The inevitability of stabilization maneuvers was almost established, as the degree of disequilibrium was so great that the Polish economy was threatened by the loss of a point of reference. The Zloty was ceasing to fulfill even the simplest of its function, the function of a unit of account.

As part of its stabilization measures, the government tightened budget controls, restrained the growth of money supply, and applied more strictly the wage indication formula that was introduced in 1989. As a result, real wages fell sharply, and to maintain consumption households had to draw on accumulated reserves of foreign exchange, leading to an appreciation in the value of Zloty. It had been legalized in March 1989. This reduced the monetary overhaul by end of 1989 and substantially reduced the existing distortions in the structure of prices. At the same time the successive

[9] Murrell, Peter, "The Transition," *Journal of Economic Literature*, Vol. 33, March 1995, p. 164.

exchange rate was devalued, against the dollar, and by end of 1989, the gap between official rate and parallel market had narrowed considerably.

By January 1990, a package of tough measures for monetary and fiscal policy were launched. Punitive wage measures were applied, which kept the nominal wage growth significantly below the inflation rate. The introduction of these measures were accompanied by comprehensive price liberalization, the cutting of subsidies, and diastolic increases in a few remaining controlled prices, notably energy products. Budgetary balance was also quickly achieved by cutting expenditures mainly on subsidies and tax exemptions. Within a period of 1 year - from December 1989 to December 1990, inflation was reduced from 79.6 percent to 17.7 percent.

Stabilization Plan

The new Polish government formed by Premier Tadeusz Mazowiecki assumed office on September 12, 1989. The session of the parliament was held on September 29, 1989. It was during this session that Leszek Balcerowicz, who was invincibly associated with the Polish reform program, presented the economic draft to the Sejm. He was the former Finance Minster and Deputy Prime Minister at the time of the adoption of the Stabilization Program and orchestrated the reform process. During that September session of the Parliament Balcerowicz presented the draft budget proposal to the Sejm. He went on to present the economic reform program on October 6, 1989. It was during his speech to the Sejm that Balcerowicz underlined the economic situation and the need to act upon. He said in a speech to the Parliament:

"The economic program has two basic layers. First: Planned action of the government. Second: Anticipated foreign assistance combines with our activities. For the government's action, we envisage two kinds of undertakings. First: Internal Stabilization, that is, struggle against inflation and common shortage of goods. Second: Institutional changes associated with this struggle, with the program of internal stabilization. The temporary increase in the deficit proposed in the tabled draft, in other words the budget debt's owed to the National Bank of Poland to a total of PLZ 4.9 trillion is in fact only a formal recognition of the financial situation, which surfaced earlier on."[10]

He further said that the course of action for the economic program fitted into a timetable, which spread over October to December 1989 for the initial stage and a phase of decisive transformation in the beginning of 1990. It was also made clear that the economic program was designed to take Poland closer to being a modern market economy and that would entail some fundamental changes. Demonopolization of the economy was one such issue to be addressed. Stringent regulations regarding bankruptcy of enterprises and property reforms were also emphasized[11]. There was also a move to improve the system of functioning of state enterprises. Enterprises based on self-management were envisaged to form a significant part of the economy. Reform of public finances was one of the preliminary points of the reform program along with social security nets and monetary policies. As Balcerowicz said while addressing the Sejm:

"The point is establishing such a relation between the central bank and the budget, which would eliminate the hitherto practice of automatic

[10] Summary of World Broadcasts, op. cit.
[11] Ibid.

financing of the state deficit. We desire to start preparing the whole system of social security, which would be suited to the market economy, adjusted to the negative consequences of fighting inflation It is necessary that we eliminate deficit of the state budget. This of course will be combined with .a restrictive money and fiscal policy. We also perceive an urgent need to accelerate work on the banking system to make it similar to that operating in the developed world."

The task of drawing up a conception of a stabilization program for the Polish economy was requested by OKP Chairman, Bronislaw Geremek, on September 1, 1989. In conjunction with it a program of systemic changes in direction of a market economy was also envisaged. The work on the program began on 28 August 1989. Janusz Beksiak, Tomasz Gruszecki, Aleksander Jedraszczyk, and Jan Winiecki wrote the final draft of the program. This team was joined by Jacek Kuron, Aleksander Paszynski, Stefan Kawalec, Dariusz Ledworowski and Jerzy Eysymontt at various times. Throughout the preparation of the report, Jeffrey Sachs and David Lipton acted as consultants to the team.

The report consisted of three parts. The first contained an outline of the stabilization program, the second one an outline of the program of systemic changes and the third part presented an proposals for the timing and sequence of the changes in the two programs and for their co-ordination. It also included a summary of the principal these underlying the whole report. The work on the report concluded on 28 September 1989 and a the report was submitted to its commissioner, the Chairman of the OKP, Bronislaw Geremek, to the Prime Minister of Poland, Tadeusz Mazowiecki and to Deputy Prime Minister, Leszek Balcerowicz. A copy of the report was also sent to the

Chairman of the "Solidarity", Lech Walesa[12]. The program was designed to run for 26 months and was intended to end by December 31, 1991.

Measures under the Stabilization Program

The stabilization program involved measures like 'forced adjustments', which included cuts in budget expenditure, withdrawal of tax concessions, imposition of new taxes, immediate restriction of credit for centrally financed ventures. The aim of these measures, as dictated by economic logic was to balance the budget and reducing the emission of money. 'Forced Adjustments", as the name suggests are forced by macro-economic situation: both internal and external disequilibrium. 13.

Apart from the 'Forced Adjustments' stabilization and reform also include 'Fundamental Adjustment,' which mean shifting resources to more profitable activities or an increase in the economic results achieved from use of the same quantity of resources. Liberalization of internal prices, together with the elimination of subsidies and the introduction of convertibility of currency facilitate transfer of resources to more profitable branches, besides clearing the profitability ranking and structure of demand. In due course the efficiency increases and the constrain of the stabilization program ceases to bother. The effects of the fundamental adjustments lead the economy to a path of stable economic growth and real rise in the income of the population.

[12] Beksiak, Janusz, Tomasz Gruszecki, Aleksander Jedraszczyk, Jan Winiecki op.cit. p.21.
[13] Ibid. 24.

The stabilization program was aimed at *returning to domestic macroeconomic equilibrium*[14], resulting after a certain time in a reversal of the trend of accelerating increases in prices.

The liberalization and privatization programs were scheduled to start with the stabilization program. This was aimed at facilitating fundamental adjustments in the economy. It was envisioned that Poland should start on the path of balanced economic growth by end of 1991. This happened to be an interesting distinguishing point for Poland, as the country was not returning to the path of economic stabilization, but was adopting the path in real terms for the first time in more than half a century.

The stabilization package also sought to *achieve external macroeconomic equilibrium,* which is an integral part of a traditional program. In case of Poland had to be formulated in an unconventional way, largely because of its previous indebtedness and the urgent need for a net inflow of resources from abroad in short term. Fundamental adjustments and facilitation of reduction in foreign debt burden was anticipated once true comparative advantages come to the fore and introduction of currency convertibility and liberalization of domestic prices brings about a shift in structure and profitability of exports during the final stages of the stabilization program.

[14] Ibid.25.

The Stabilization Program was divided into thematic blocks, in order to ensure creation of real conditions for economic growth. These were price reforms, budget balancing, tax reforms, credit restriction and currency convertibility[15].

Price Reform: All controls on prices in agriculture and industry had to be abolished, with two exceptions:

- Fuel and energy prices. The basis for domestic price was the transaction price or the world market, The actual domestic prices, were supposed to be 75 percent of the transaction price until December 31, 1991.
- Agricultural procurement prices: Where the domestic prices were to be freed from control but the principle adopted was that price increase by the state & co-operative units was not exceed the percentages increase in procurement prices paid by processors.
- **Budget Balancing:** It included measures such as introduction of an energy and raw materials tax on exports, imports and domestic sales of basic fuels, energy and selected raw materials.
- Abolition of exports subsidies in connection with introduction of convertibility of the Zloty at an exchange rate ensuring high profitability of exports.
- Abolition of income tax concession for export.

[15] ibid. 26

- Radical restriction of budget subsidization of central investments and of enterprise investments subsidized by the budget, with protection for infrastructure investment and heals and education.

- Abolition of food and agricultural faced subsidies.

- Reduction of the border on the budget connected with the servicing of debt to foreign commercial banks.

Tax Reforms: A uniform easily collected income tax on economic subjects, an income tax on the personal incomes of the non-agricultural population and consumption tax and excise was envisaged. The aim of the changes proposed was to make the conditions for evaluation of the profitability of economic reform as uniform as possible.

Banking Reforms: Introduction of real rate of interest and the restriction of credit were the prime components of reform of the banking system. The measures included:

- Adoption of the principle of a positive real rate of interest on credits granted by the bank, which was a nominal higher than the rate of inflation.

- Restriction of the extent and standardization of the rates on preferential credits, confined to agriculture and housing.

- Radical restriction of the credit granted for central investments financed by central credits, with the same principle as in the case of balancing the budget. Infrastructure investment and health were made protected areas.

- Introduction of other two instruments, along with the positive real rate of interest. This was to increase the propensity to save.

An independent banking system was initiated in Poland in 1987. By 1990, a rudimentary two tier banking system was in place. With further steps and laws in place banking has developed as developed sector of the economy. The Polish fiscal reforms were aimed at shifting to value-added tax and introduction of a uniform, progressive income tax, starting 1996. Transparency and differentiation were the key attention areas.

Convertibility of the Zloty: This was taken up in context of correction of the Balance of Payment and reduction of the burden of foreign debt.

- The key measure included is the introduction of full convertibility of the Zloty.

- Possibility of domestic and foreign economic subjects & households to be able to buy and sell foreign currency at the going exchange rate.

- Talks with CMEA countries with the aim of introducing trade on the basis of settlement of balances in convertible currency.

- Talks with crediting (Poland) in the West and East with the aim of securing reduction in the burden of debt (according to the principle of the Brady Plan).

- Talks with the IMF and World Bank to speed up possibility of obtaining loans to support economic programme.

Program of Systemic Change

The program of systemic change was directed towards creating and developing in Poland a Western-type market economy[16]. No alternative was sought to be considered by the planners and decision-makers. Liberalization of economic relations was one of the prime concerns of this program. Freedom of economic enterprise for the citizens had to be ensured and the matters of the state had to be defined statutorily. Demonopolization of the economy an inseparable part of the program. Unblocking the operation of market regulating forces such as wages, prices, interest rates and exchange rates were few key areas identified for the move on liberalization. Eliminating the monopolistic organizations was another associated move. Initiation of a campaign to review and abolish regulations that limit economic activity, such as sale of land, housing and fixed assets was also sought.

At the core of the transition process, from centrally planned to market economies, is the creation of the legal institutions, which support the market

[16] Ibid. 37.

economy system. However, a more difficult problem has been to create a micro-economic foundation for systematic change. Decentralization of decision making, privatization, price liberalization, creation of two tier banking system and liberalization of foreign trade are some of the priority elements.

Progress in creating a new legal foundation for a market economy has been quite fast in Poland, where the large majority of fundamental new laws has been passed or prepared since autumn 1989.

Another feature of economic transformation is price liberalization. Prices were liberalized on all fronts except energy, resist, transport and communications. In Poland, the remnants of the rationing system for private consumers was abolished in 1989, and subsidies on consumer goods were reduced.

In Poland, some steps towards the liberalization of foreign trade had already been introduced in 1980's especially with regard to trade with convertible - currency countries. This was reflected in a large increase in the number of firms holding permits, allowing them to make independent arrangements with foreign partners. Now foreign trade became completely liberalized for firms, and custom duties and exchange rates replaced administrative regulations. The Zloty can be adjusted to the US dollar to ensure profitability of bulk exports and retention of foreign exchange for imports is possible. Internal convertibility has also been introduced. Trade liberalization and economic integration with the world economy has been considered in the fourth chapter.

Poland started at a slightly sluggish note at the privatization front. Private property rights has always been a difficult area as well. The issue of privatization has been discussed separately in another chapter. The problem gets coupled up with a lock of measures to ensure valid and accountable privatization. The main issues confronted on the issue include, viability of companies, breaking up of monopolies, distribution of wealth, lack of domestic capital market, lack of qualified business managers and large no of state owned enterprises. The law on privatization incorporates the following:

- Foreign investors can acquire more than 10 percent of the nominal shares of a company only with the consent of the authorities.

- A feasibility study must be carried out to determine the value of a company and the required organizational and technical changes before issuing stocks.

- Employees of the company concerned have priority in buying up to 20 percent of the nominal stocks of the conceived company at half the issue price Polish privatization in petty business caught up on a speed in note.

Inflation

Galloping inflation was one of the key indicators of economic malaise within the Polish economic system. Repeated attempts to control and correct the price mechanism, without making fundamental changes failed to ease the problem. Inflation stood at an extremely high figure, when Poland commenced its stabilization program. Figures ranging from 55 percent to 1000 percent have been quoted, but the fact that it had reached alarming levels worried economic decision-makers. In 1990, the level of inflation was so high that it exchanged at 9500 Zlotys to a US dollar. Even Balcerowicz conceded to the issue of inflation haunting the economic planners and as being a component of reform measures during the Parliament session, where he had just presented the draft of the economic reform program.

> *"The figure is 900 percent, based on the assumption that we reduce the sphere of the indexation of remunerations."*[17]

However, inflation soon came to be controlled using stringent fiscal and monetary tools. Inflation reduction and maintenance of financial discipline have been successful in Poland, despite the extension of credits to finance budget deficits, owing to an increase in the amount of private savings that were channeled into bank deposits, especially in 1992. These deposits were equivalent to total financial wealth[18].

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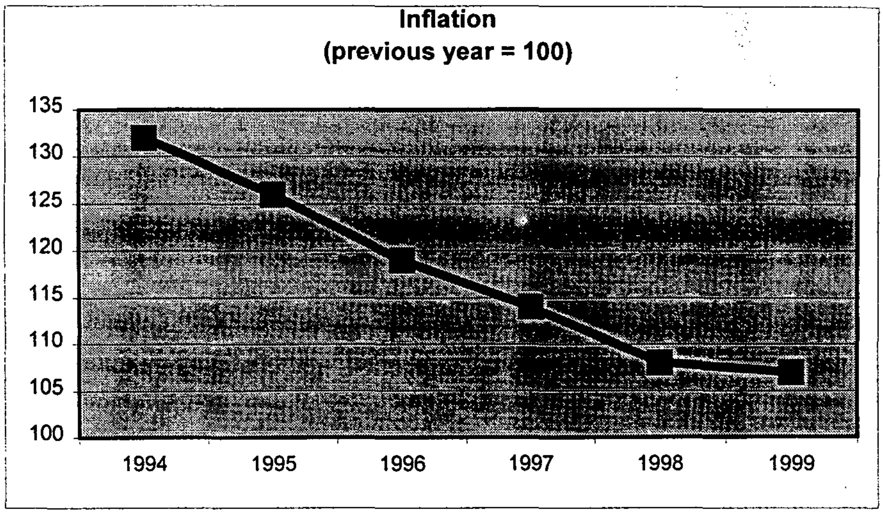
[17] Summary of World Broadcast, op.cit.

[18] Ebrill, Liam, Ajai Chopra, Charalambos Christofides, Paul Mylones, Inci Otker and Gerd Schwartz, *Poland: The Path to a Market Economy* (Geneva: International Monetary Fund, 1994) p. 24.

Figure 2.1

Inflation Trends in Poland (1994-1999)



Source: Embassy of the Republic of Poland, New Delhi

Inflation has been largely tamed in Poland and the figure now stands in single digit[19]. However it still can be brought down and supported by disciplined fiscal policies. Some international developments have also aided in curbing inflation. Commodity prices have eased, and collapse in exports of food products to Russia and Ukraine has led to intense price competition in the domestic market[20]. On the whole Poland has managed to cool down its overheated economy and this year the inflation is expected to fall to 5 percent from the previous years 7 percent, provided appropriate fiscal policies are maintained.

[19] IMF Outlook for Poland, http:/www.org/external/np/speeches/1999/121099.htm

[20] *Trade Policy Review Poland 2000* : Geneva: 2000, World Trade Organization, p. 6.

Exchange Rate

Adoption of exchange rate regimes is one of the key issues faced by any economy making a transition to a market economy. It is largely a function of economic objectives, initial conditions and sources of external influence on the economy.

In context of transition economies, a fixed exchange rate system has often been regarded as an anchor for domestic price performance. It also helps solve the problem of setting relative prices that are generally distorted under the planned systems. Basically, fixed exchange rates can work to stem high inflation and help realign relative prices after opening domestic market to trade, by importing foreign prices into the economy[21]. Although, one prime difficulty with fixed rates is the determination of rate and the currency to peg to. Fixed exchange rates may also become unsustainable if they are not adequately supported by appropriate policies. It can also lead to a loss of competitiveness and capital outflows.

A flexible exchange rate on the other hand, provides in principle the authorities with an independent monetary policy and helps promote international competitiveness. However, uncertainty concerning the path of exchange rate can adversely affect production and trade confidence.

[21] Ibid. p.43

Selection of an exchange rate is also a function of the nature of shocks that the economy is undergoing at the given point of time. To the extent that the policy aims at stabilizing output in the face of transitory shocks, a flexible exchange rate is desirable, especially when the shocks are external or originate form the real side of the economy. A fixed rate is preferable if the shocks have a domestic and monetary origin[22].

In case of Poland, both high inflation and large external imbalance were pressing problems when the reform process was initiated. Relative prices were severely distorted after decades of price controls. A significant monetary overhang existed in the economy due to output shortages and potential inflationary outburst at liberalization of prices threatened the system. The initial choice of the reform program was to peg it on a fixed rate as a nominal anchor to brake the emerging hyperinflationary pressures [23]. Fixed rate was also chosen owing to the lack of any foreign exchange market. In spite of a weak external position, the requirement of adequate foreign reserves to cushion against volatility in foreign exchange transactions was met by foreign reserves equal to 3.5 months of convertible currency imports. The reserve position was further boosted by availability of a stabilization fund amounting to 2 months of imports[24]. The fixed exchange rate was temporary but it lasted more than anticipated.

[22] Lavigne, Marie, *A Comparative View of Economic Reform and in Poland, Hungary and Czechoslovakia,* UNECE Discussion Papers, (Geneva: United Nations, 1994)p.12.
[23] Ebrill, Liam, op.cit. p.44.
[24] ibid. p.44

In the 1980's Poland had a system, where the value of the Zloty was determined in terms of basket of currencies and adjusted periodically with a view to ensure profitability of exports. There also existed an unofficial market for foreign exchange, where the value of the Zloty was determined by market forces. As inflation rose, the size and frequency of the adjustments in the official exchange rate increased. The devaluation became sharp in face of legalization of the parallel exchange market. In fact the Zloty was devalued about ten times during the last quarter of 1989, thereby causing the value of the currency to fall by 90 percent. On January 1, 1990, internal convertibility of the Zloty was introduced and the foreign exchange market for current transactions was unified at a rate of PLZ 9500 to a dollar. Breaking the hyperinflationary pressure was the motive behind this move. The exchange rate was shifted to the peg basket in May, 1991, mainly because of the increasing tilt of trade with Western Europe. The Zloty was devalued 14.4 percent against this basket. This basket consisted of US Dollar -45 percent, Deutsche Mark -35 percent, Pound Sterling -10 percent, French Francs -5 percent and Swiss Francs - 5 percent[25].

Poland during the course of its reform program has adopted various forms of exchange rate mechanisms. They include pure fixed exchange rate via-a-via the US Dollar, a switch to a fixed peg against a currency basket and a move towards a pre-announced crawling peg. Broadly the policy has been

[25] Schwartz, Gerd and Tessa Willgen, "Beyond Stabilization: The Economic Transformation of Czechoslovakia, Hungary and Poland," *Communist Economies and Economic Transformation*, Volume 6, No. 3, 1994, pp. 293.

deemed successful in meeting the objectives of controlling inflation and maintaining competitiveness. Poland has increased its market share in the West and attained a sizeable amount of foreign exchange reserves. Currently Poland follows the Crawling Band system of exchange rate.[26] The National Bank of Poland is responsible under the constitution for safeguarding the value of the currency. In February 1998, an independent ten-member Monetary Policy Council, chaired by the bank's President was established to strengthen the Bank's independence in setting up the required policies. The Bank's main aim is to maintain price stability while also acting in support of government economic policies. [27]

Recent changes in the exchange rate system to move to a wide fluctuating band with a slowly crawling central parity pegged to a currency basket have added greater flexibility to exchange rate mechanism[28]. Poland is now seeking to apply for European Monetary Union membership in 2006. The Polish monetary policy aims to achieve an annual inflation rate of under 4 percent by 2003. It also intends to join the new exchange rate mechanism (ERM2) in 2004, for which it will need to peg the Zloty against the Euro within the prevailing fluctuation margins (currently + or -15 percent). The Government intends to move to a floating exchange rate so as to let the currency find equilibrium before it enters ERM2.

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[26] Camdessus, Michael, http://www.imf.org/external/np/sec/pn/2000/pn0025.htm
[27] Trade Policy Review Poland 2000 op.cit.p 5. 5
[28] Ibid. p.6

Stabilization Program: An Assessment

The legendary Economic Transformation Program, launched on January 1, 1990, was designed to stabilize the Polish economy, promote structural reforms and put the country on the track to becoming a market economy. The country has benefited immensely from the difficult yet effective market-driven mechanisms into the economy. It was the first country, among in the region to rebound from transformational recession and exceed GDP levels seen before post-communist reforms. A moderate recovery during 1992-94 was followed by robust growth (the fastest in Central Europe) during 1995-99[29]. Poland's economic transformation program has been lauded by international financial institutions and observers at various levels, particularly for its resilience in a turbulent international financial scenario. Poland's success has been attributed mainly to its balanced and consistent macroeconomic policy, structural reforms and relatively strong and transparent financial system[30]. Polish economy has proved strong enough to withstand very tough times. After the GDP slowed growth slowed to 1.7 percent in the first quarter of 1999, as the result of the Russian crisis, it rebounded to more than 6 percent in the fourth quarter of 1999 and the first quarter of 2000. Consumer confidence, strong foreign trade and steady - low inflation levels are being observed. Poland is now witnessing an expedited economic growth.

[29] Poland's Transformation, http://www.imf.org/pubs/ft/fand/2000/09/balcerow.htm
[30] Ibid.

Privatization in Poland

Introduction

Privatization in Poland, like in any economy was driven by the objective of increasing the effectiveness of the economy and enhancing the efficiency quotient of the enterprises. It also sought a role of a catalyst in transforming the economy, in the market creation process and in facilitating the qualitative upswing in the labor market. Not only this, privatization in post-communist nations was marked by an absolute restructuring of the economy from its existent form to an entirely different form with new institutions and rules. The gamut of state-owned giant structures needed to be processed into privately owned firms, coupled with restructuring the institutional framework and putting regulations governing non-state entities into place. Training of thousand of managerial cadres, promotion of consulting industry and demonopolization of the economy were the tasks accompanying privatization.

The first post-communist government headed by Tadeusz Mazowiecki commenced its mission in summer of 1989. Then came along the economic stabilization package and the reforms. At the point of time, the focus of political and economic decision-makers was not solely concentrated on privatization. It came as a part of the entire reform package, along with stabilization and liberalization program. Regarding macroeconomic issues, the choices were evidently obvious and there existed a general agreement on the issue. Ownership change was peculiarly characterized by lack of consensus and political lag added towards delaying the process further. Not to forgo, the clash of interest groups and redistribution of power and wealth shaped it up into much more than an economic process. The round table talks between Solidarity and the communist government revealed a polarization effect on the issue of privatization. Although there was a clear recognition for the need to privatize and put into effect ownership changes and institutional transformation, the issue of privatizing the economy did not get the kind of attention it sought amongst the political parties. In summer of 1989, Poland's first Employee Share Ownership Plan (ESOP) was announced, which won immediate approval from the Solidarity Union Activists.[1]

Before we consider the case of Polish privatization, let us have a look into the privatization keeping in perspective various views and conditions. We shall also make an earnest attempt to assess the various approaches, theories and practices of privatization.

Privatization: Objectives and Approach

Privatization was viewed as an integral part of the program of systemic change, and was aimed at creation of an efficient market economy. It was driven by the idea of freeing people from the 'fetters of the economic system of the past,' to create opportunity for the spontaneous and make way for development of market relations[2]. However, it was kept in purview that

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[1] Tomasz Mickiewicz and Maciej Baltowski, "Privatization in Poland: Ten Years After", *Post Communist Economies*, Vol 12, No. 4, 2000, p. 428.

[2] Beksiak, Janusz, Tomasz Gruszecki, Aleksander Jedraszczyk, Jan Winiecki *Outline of a Programme for Stabilization and Systemic Changes* (London: CRCE, 1989) p.43.

privatization of a state super-structure and related property had to be a steady process. The program initiated the creation of a policy of privatization for accelerated results. This policy sought to provide economic incentives for privatization, create institutions meant to serve the privatization process, mark-out priority areas and align the entire program of systemic changes so as to obtain maximum results out of the desired move. It had been contended earlier that privatization can be successful only if the economy is liberalized in advance or, at least, in parallel with it. Stabilization of the economy was considered a pre-requisite for initiation of the privatization program. It was meant to reduce the exceptionally high degree of uncertainty, which could affect the privatization initiatives and results. Adoption of a 'privatization program' was envisaged, which was to function as an autonomous program.

The main aim of the privatization was the creation in shortest possible time, of the conditions for the free movement of capital, with a preference for individual private ownership, rather than institutional or collective owners. The preferred model of privatization was thus to lead to a rapid increase in the extent and strength of the private sector, diffusion of ownership and increasing the population of private entrepreneurs in the economy[3].

The team that was working on the Stabilization program and the systemic change plan had proposed that as the first radical step, a proclamation be made on 1 November 1989. It said that 20 percent of the shares in each state enterprise employing more than 250 persons be transformed into a joint-stock

[3] Ibid.44.

company on 1 January 1990. It would then become the property of the workforce, including management of these enterprises. These shares carried voting rights to the supervisory council and the remaining 80 percent of the shares being the property of the state treasury would be deprived of these rights, until they were sold or transferred to citizens. Such a move was targeted to broaden the stratum of owners bearing capital risk and lead to desired diffusion of ownership. It also sought to transform to almost undefined 'general national property' into unequivocally defined private property. One of the key functions of such an action was to facilitate the flow of capital through the stock exchange into the most efficient uses, thanks to guaranteed transferability of shares.

Besides the traditional aim of privatization, which accompany any given program, these measures were meant to solve a fundamental problem of the Soviet-type economy and that was to radically shorten the transition period from abolition of the founding organs and the *nomenklatura* system to full privatization of enterprises. The transfer of shares carrying the right to vote in elections to supervisory boards to the employees of these enterprises identified private owners who, until the sale of the remaining 80 percent of the shares are through the supervisory council, the sole decision makers on the affairs of the enterprise.

On the question of sequencing of the privatization process, the following three options were identified as most important.

- Privatization of small enterprises and tangible assets.

* Selective privatization of medium and large enterprises.
* Mass privatization of medium and large enterprises.

A task of the scale of privatization of state enterprises required an appropriate institutional basis. Even if the privatization process lasted ten years or so, as a transitional process of its nature needed a separate institutional support to serve its purpose. Creation of the National Wealth Fund (FMN) was one of the proposed bodies to assist in the process of privatization. FMN was envisaged to be a special liquidating agency set up to carry out the process of privatization as rapidly as possible. Its responsibilities included implementation of the Polish Privatization Program, adopted by appropriate authorities, within the limits set by the law, in accordance with the principles adopted, following methods laid down, in time envisaged and in the sequence defined.

Since privatization was a logical extension to the move, in which the shift from centrally planned economy to that of a market economy had to be made. Theoretically, since the Eastern Europe and Poland in particular did not seek any ideological "third way" between communism and capitalism, any kind of market socialism and workers' self-management, creation of a full-fledged market economy was seen as the next best possible choice. So the priority status for privatization came naturally, when the creation of a real market economy, assisted by a large and independent private sector became imperative. There also existed a difference of opinion amongst economic analysts. The ideological choice existed between liberal views, which was a relatively new trend and socialist-self-governing views. The latter was a well-established tradition within the Solidarity Union. However, both the options were equally weighed and considered by the Solidarity Union.[4]

There was a lobby which believed that merely freeing prices could create market economies, abandoning the most visible signs of centrally planned economies. Privatization in such a case was expected to follow later, without any underlined need for rush. However, the regional reformers knew better, it seems. They viewed it as a case of having capitalism without capitalists. Freeing prices replaces the necessary ignorance of central planners with usable information. Prices are signals that tell the economy how its resources can be best be used. But unless its those resources and all above all its productive assets are privately owned, the signals simply tend to be ignored[5]. It was simply proved that to create a market economy, private ownership was required. However, to create a private ownership, there should be a market economy, else it was not possible to value the assets that had to be privatized. The challenge in case of the Polish privatization came in form of more than 7,800 odd enterprises for privatization, in a vacuum of rules and procedures governing privatization and also the free play of market forces[6]. The perplexity lay in figuring out how to privatize all these vast array of firms in a manner that was equitable, swift, politically stable and likely to create an effective structure of corporate control. The complications in

[4] Ibid. p. 425.
[5] "From Marx to Market", *The Economist*, May 11, 1991. p. 11.
[6] David Lipton and Jeffrey Sachs, "Creating a Market Economy in Eastern Europe, A Case of Poland," *Brookings Papers on Economic Activity*, 1:1990, p. 127.

privatizing the state owned enterprises were doubled by the stupefaction of political control. The communist managers assumed that they own the right to trade, lease, sell, merge an enterprise or its assets for their own good and often leading to fury from the public[7]. The workers also wondered on the new found problem privatization, when in theory they owned the firms. As Dr Jeffrey Sachs suggested, privatization should begin by establishing with certitude that the central government owned the enterprises and had exclusive power to engage in privatization. He argued that on grounds of social equity, the government should reject the workers claim to full ownership of the enterprises, as industrial workers constituted only 15 percent of the total population and only 30 percent of the total workforce. He however argued that they could be given preferential access to a modest fraction of the shares of the enterprises and also by offering seats on the corporate board, much in tune with the company laws in Western Europe. The idea was to transform enterprises into private corporations, with transferable shares and not alternatives like co-operatives or self-management, as it entailed the risk of cutting-off the firms from capital markets and ran a high risk of profits being diverted to workers by themselves [8]. The need to devise effective, fast and transparent mechanisms for selling the enterprises or for transferring ownership to the private parties seemed to be the mammoth task when the privatization bid was initiated. There was an option to sell the shares directly to the public, say for example a

[7] "Eastern European Economies: What is to be done", *The Economist,* January 13, 1990, p. 20.
[8] "Charting Poland's Economic Rebirth", *Challenge,* Jan-Feb 1990, Vol 33, No 1, p. 24.

portion or rather a fraction of the enterprise of the enterprise given to the workers or stakeholders, or the same could be given to mutual funds or holding companies. Joint ventures, mergers with private enterprises were other possible alternatives. Participation of foreigners in purchase of shares required control and the preference stood for cash paid ownership or foreign equity.

Creation of financial institutions catering to the needs of small business was another priority area on the privatization list. With state owned enterprises enjoying the bulk of the banking and finance pie, attention to the small and medium enterprises so that they could gain a proper foothold came as a natural choice. The private sector had an average 2.7 percent of the total credit from the banking system, amounting to a miniscule USD 120 million.[9]

There were two prominent determinants of the privatization strategy, as explained by Jack Kwasniewski. The first determinant was the structure of the economy and the second was the need to transform the economy as fast as possible. Kwasniewski suggested a multi-track approach; i. e differentiated approach to different companies. This was owing to the fact that within the state run sector, 7 percent of the companies delivered nearly 50 percent of the production, whereas 50 percent of the enterprises delivered only 8 percent of the output. He suggested that the first category of enterprises would include the 100 largest Polish companies. These companies had an enormous impact on national sales, employment and investment. These were the flagship

[9] Lipton and Sachs op. cit. p. 131.

enterprises, which were significant and visible to the entire economy. Therefore, they required detailed attention of the Ministry of Ownership Changes. Given the heterogeneity of the segment, all privatization efforts had to be custom-made. This entailed large teams of experts to analyze and design strategies[10].

For restructuring medium-sized enterprises, a slightly different approach had been suggested. In their case, it was easier to permit more modalities or options like leasing. Since the risk factors are relatively low, it was possible for Polish entrepreneurs to manage them, in the given state of management and entrepreneurial skills. Trying out a wider modalities rate also stemmed from the fact that these enterprises were relatively less critical to the national economy. Medium-sized poorly performing firms had an option to be liquidated or restructured. Their assets could be sold off to public. For the firms, which were performing well, public offers, private placement, joint-ventures and contracting were the available options. Entrepreneurial Development Programs for enterprise workers and others who sought to launch their own private business were also thought of.

Small enterprises, which were a large sector in numerical connotations, had a little economic importance in terms of output and impact. The only significant part was their over-whelming presence. Rapid privatization of the small enterprises had been encouraged and small businessmen were expected to set up small manufacturing plants. The small size, heterogeneous

[10]. Kwasniewski, "Privatization: Poland," *Eastern European Economies*, Fall 1991, p. 42.

composition and geographical dispersion called for rapid privatization, primarily through bidding and private placements[11].

The speed of approaching the privatization process was one of the most important deciding factors for the privatization strategy. In this regard, it will be helpful to understand the concept of cluster privatization, where companies were not dealt with individually but clubbed together as sectoral industrial bases. There were groups of 12-15 such companies and a set of experts, mostly from the western companies, assisted in privatizing and restructuring them. This example was emulated in construction industry, brewing industry and automobile parts making industry. Cluster privatization promoted sectoral restructuring and there was a credit system, which could be used for leverage, buy-out methods, leasing with gradual sale.

Free distribution of shares was another popular and well-known way of speeding up privatization, although it was marred by a great deal of complexity.

Equivalent Privatization

The idea of equivalent privatization was announced officially in the Beksiak Group Program, prepared by Professor Janusz Beksiak in association with a Group of Economists affiliated to the Catholic University of Lublin, namely Tomasz Gruszecki, Aleksander Jedraszyk and Jan Winiecki. Privatization formed a big part of the program, which was devised at the

[11] Ibid. p. 45.

request of the presidium of the Solidarity based Citizens' Parliamentary Club in September 1989.

According to the scheme, all enterprises with over 250 employees were to be transformed into joint-stock companies by January 1, 1990. Twenty percent of the shares were to be allocated free to the employees and remaining 80 percent of the shares were to be taken by the State Treasury and made available to the private investors later on, on a mass or a limited scale depending on the type of enterprise. Major corporations like the Polish State Rail, Mail and military sector were excluded from this plan.

Establishment of a National Property Fund for smaller enterprises, with less than 250 employees was proposed and the fund was aimed to supervise takeovers from the founding bodies of these firms, with a view to prompt sale thereof. This procedure is also referred to as direct privatization.[12]

Non-Equivalent Privatization

The decision to opt for non-equivalent privatization of state enterprises i.e. mass privatization or employee privatization was already perceived as highly probable in the autumn of 1989, irrespective of its economic viability. This was owing to the fact that the consensus of the Round Table talks was not very pro-market and capitalism. This was coupled with the social expectations to involve employees and citizens in privatizing the national property. However, the concept came under fire from the Government

[12] Mickiewicz, op. cit. 428.

Plenipotentiary for Ownership Transformation, Krzysztof Lis, who advocated that such solutions were likely to hinder development of market economy. The collective ownership concept was likely to block development of capital market, stock exchange and financial mechanisms of investment allocation. [13]

Whatever the approach to privatization, multiple means of doing it had been emphasized and they had to be rapid. Restraint was sought so as to not to make the process reckless and still achieve basic objective of private ownership. The need for growth opportunity required for effective management and good corporate governance also could not be undermined.

Problems of Privatization

Privatization in Poland came up as the second part of the reform program. It sought to eliminate restrictions on private economic activities and enactment of new laws to facilitate the same. Poland faced an upheaval task of updating its commercial codes from the 1930's. Company laws had to be redone and had to be prepared so that they would promote establishment of new enterprises. Newer and competitive tax laws had to be put in place, in order to remove the punitively high marginal tax rate that prevailed at that point of time. Also the various licensing restrictions that were applied to international trade and domestic investment had to be eliminated.[14] The next move was perhaps the hardest in a bid to initiate privatization. The step to discipline state enterprises, which by no means was an easy task, especially in an environment where soft budget constraints ruled the day. Soft budget

[13] Mickiewicz, Ibid. p. 429.
[14] Kwasniewski, op. cit. p. 43.

constraints, a term coined by Harvard Professor, Janos Kornai, refers to cheap credit, subsidies, tax breaks and similar instruments that have cushioned enterprises from rigors of real competition and have also led to imprudent investment.[15] It also implies that there is no financial discipline, owing to the fact that a firm's losses are not the concern as the government makes up for them. Any profits too would not make a difference to the managerial ranks. The simplest solution suggested to solve this entire issue was to cut down drastically the number of state enterprises, however that could only be done in due course of time.

As Jeffrey Sachs, economic advisor to Solidarity, suggested, all such enterprises should be subject to real market disciplines. Private firms and importers had to be allowed to compete and subsidies required an unbridled cut. Cheap credits and tax concessions had to be done away with. Borrowings on the basis of central government guarantees had to end and loss makers had to be forced to go out of business[16].

One of the top facilitators of the privatization process has been the Polish Privatization Agency. It is a legal state entity established by virtue of the Law on the Office of Treasury and the statute granted by order of the chairman of the Council of Ministers. The Ministry of Treasury supervises the agency. The agency is a specialized body established to privatize treasury companies, companies in which the treasury has its share and also state and communal enterprises. The agency sells corporate shares and stakes and

[15] Sachs, op. cit. p.127.
[16] Sachs, (b) p. 25.

disposes off the assets of the state enterprises on the basis of the treasury ministry's authorization, which determines the range and conditions of privatization. The agency also conducts privatization process on the basis of the Law on Commercialization and Privatization of the State Enterprises through the privatization paths, such as, written tenders, invitation to negotiations and public offer.[17]

Common Privatization Methods

There were two methods of privatization used in Poland. They are:

1. Indirect Privatization (through corporatization)
2. Direct Privatization (via liquidation)

1. Indirect Privatization

Under this method as one of the initial steps in the privatization process, a state owned enterprise (SOE) is converted into a standard joint stock company. It is regulated by the commercial code and not by the old Law on State Enterprises. The state treasury takes over the 100 percent shares of the company, which marks the corporatization or commercialization of the enterprise. After this process, the firm is transferred from the government records' register i.e. the parent government agency, like the ministry or regional authorities, to the jurisdiction of the Ministry of Privatization. According to the 1990 legislation, the Minister of Privatization was under an obligation to make the shares of concerned company available to the buyers within two years of corporatization. This somehow was flouted in practice

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[17] http://www.msl/en/agencja/ap11.html

and in 1996, this clause was amended.[18] The corporatization process is followed only after a request is received by the Minister of Privatization from the managing director and workers' council after co-ordinating with the 'founding agency' or the parent government agency. In other case, a request is received from the parent government agency with the consent of the director and workers' council after consultations with the general assembly of the employees. In a few exceptional cases, the Prime Minister upon the request of the Minister of Privatization transforms a state enterprise without the consent of the related inside parties. This process leads to the decrease in the workers' control over the enterprise as the workers' council ceases to exist. Instead, a standard supervisory board or a board of directors, consisting of one-third members elected by employees and two-thirds appointed by the Minister of Privatization come into place. Nearly 15 percent of the shares are reserved for employees, since after privatization they lose their right to elect one-third members on the board. Reduction to the limit of 20 percent in the restrictive excess wage tax levied on wage hikes abolished in a bid to garner insiders' support. Corporatized enterprises were given a rebate on asset tax or dividend levied on a portion of the book value of the capital of state enterprises.

1.1 Capital Method

It is used as a privatization method in case of large SOEs, which exist in relatively good financial condition. The shares in the joint-stock company are

[18] Schliwa R, "Enterprise Privatization and Employee Buy-Outs in Poland: An Analysis," http://www.ilo.org/public/english/employment/ent/papers/ipred2.html.

sold to investors through initial public offerings (IPO) or trade sales, outside the stock market. However, any given privatization effort could be an outcome of one or more methods, depending on the assessment of the situation.

1.2 Mass Privatization Method

This method also consists of two sub-methods.

- Participating Enterprise
- National Investment Fund (NIF)

Participating Enterprise

Under this program, the insiders of a company have to accept the invitation sent to them by the government. An objection can be raised by the enterprise director or the workers' council within 45 days. In July 1995 and again in December 1995, the shares of 512 participating companies, equaling 10 percent of the public sector production potential was distributed among 15 NIFs, the state, the treasury, and the employees of these companies.

National Investment Funds

NIF's were established as joint-stock companies and thus as closed-end investment funds. Initially 100 percent shares were owned by the treasury. Then 85 percent of the share capital was transferred to certificate holders and the government retained the 125 percent for fund management. During the transition phase, all dividends were allocated to a fiscal account for the benefit of the certificate holders, who were entitled to get them at the end of the final transfer of ownership.[19]

Direct Privatization: Liquidation

This method is assumed to be a fair alternative for companies, which go into genuine liquidation, i.e. that is not legal or formal. These companies need to liquidate as a result of poor financial and economic performance. Poor performance is defined as a situation, where the after-tax profits are not sufficient to cover the obligatory 'dividend' to the state budget or the firm is operating at a loss. The government usually appoints a liquidator, who replaces the earlier management. State enterprises with insufficient assets are declared bankrupt and the assets belonging to such companies are sold off.

Privatization: Results and Prospects

Poland has made some substantial headway while treading on the path of creating a market economy and subsequently carrying on the privatization bid. Consumer goods and banking have been termed as the most successful sectors. Adoption of appropriate legal regulations and relatively high disclosure standards for private companies have made Poland adequately transparent. Growth of market institutional structures that facilitate functioning of the free market is another post-privatization result in Poland. Although, the process has been slow and entailed broad participation from

[19] Mickiewicz, op. cit., 437.

the concerned parties to make it a success, it made a decent contribution towards creating private ownership and businesses.[20]

The privatization attempt in Poland was an unprecedented and unique endeavor, which is highly unlikely to be replicated. The basic groundwork and privatization has already been accomplished in Poland and what is left to be done are highly specific cases, which do not come under general and tested procedures.

Currently, the steel and confectionery industries are being privatized. The more difficult sectors like energy, telecommunications, mining, and military are next in the pipeline. The results of these privatization initiatives show a positive trend on the performance of various projects. Studies have proved that privatized enterprises invest more, have developed long-term strategy, use state-of-the-art production techniques and work on newer market based products. Their management systems undergo ceaseless improvements and quality is the watchword for most of these enterprises. [21] However, ownership structures have proved to be a performance-determining factor in case of most of these companies. The results are better in case of companies with an institutional owner as its principal shareholder, which is in most cases a leading Polish or an international corporation.

Mushrooming small and medium size enterprises offering new economy outlook and enormous employment opportunities are actively

[20] "Moving Ahead: Privatization in Poland," Economic Reform Today, Number 2, 1999, http://www.cipe.org/ert/e32-04.php3
[21] Privatizing Poland, http://www.mckinseyquarterly.com/article_page.asp.19&ar6L2

replacing old time heavy industrial giants in Poland. The latest estimates peg the figure at 2 million small and medium size enterprises or SME's, which produce almost half of the country's GDP and employ nearly 60 percent of the total workforce. The Polish SME sector has grown at an unprecedented annual rate for the last 9 years. [22] Interestingly, these are the same small traders, who appeared from nowhere and did brisk business, when the transformation process of the 1990 was initiated. However, the problems for these SME's are not less. Under-capitalization, lack of money and difficulty in raising funds from the banks continue to mar their operations. Competition from foreign companies and lack of expertise and resources adds to the problem. There have been efforts on the part of the government to facilitate growth for these SME's. As an expert at the Polish Economics Ministry, Miroslaw Marek put it, outlining the governments' action[23].

" The state has started a number of technical programs to help SME's become more competitive. These are programs supporting, for instance, the introduction of technological changes to Polish companies or supporting human resource development and they are also supporting to a small extent access of SME's to financing. The government aid is also designed keeping in mind the concerns about competitiveness as Poland prepares to join the EU. The local SME sector is still expanding, although it is exposed to competitive pressure from the EU."

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[22] Poland/Hungary: Can Small Business Lead to Prosperity?, http://www.rferl.com/nca/features/2000/03/F.RU.000328133330.html
[23] ibid.

An interesting success story in case of Polish privatization case is the unprecedented success of Polish ship-making industry. Nearly two decades ago, the shipyards were designed to cater to the needs of the Soviet clients and functioned as heavily subsidized enterprises. After the fall of the communist bloc, the onset of reform and privatization process made things turn around. Years of cost-cutting, deals with creditor banks and a shift to building specialized vessels with higher margins helped Poland become the fourth lárgest ship-maker in the world. It does not subsidize production any more and enjoys a distinct competitive advantage from its competitors like South Korea, Japan and European Union. [24] It was during the 1990's that the Polish yards sank after the collapse of the Soviet Union, which reduced the output levels by half. There was a strong dissenting view from politicians and unions alike on the very issue of privatizing the industry, which was losing out owing to its poor financial standing. However, it forced the initiation of the reform and consolidation process. The first wave of reforms resulted in creation of strong ship-building hubs in Gdynia and Szcecin and a repair yard in Gdansk. Approximately, 200,000 Poles are presently employed in this industry.[25] Analysts are of the opinion that as world ship building countries move away from state subsidies, with EU hoping to effectively end state aid to yards by 2004, Poland is bound to have an advantage[26] - the advantage of having remained steadfast under pure market conditions for years.

[24] Polish Shipyards Go Upmarket to Find Success. http://www.centraleurope.com/polandtoday/business.php3id=300118
[25] NewsLink Poland, http://www.newslinkservices.com/pol/010301
[26] ibid. p.2

The privatization process, which began in Poland 10 years ago, is on verge of coming to an end. Let us consider some of the summarized results as expressed by analysts, researchers, economists, academicians, industry components and the government. It is expected that the Polish government will declare privatization to be concluded by end of this parliamentary term, scheduled to end in September 2001, by when the state ownership in the economic sector, measured by its contribution to GNP, shall not be higher than 20-25 percent. This is a level comparable with the West European countries[27].

From the historical perspective of these ten years, the principles of privatization adopted and the relevant choices made have yielded positive results. The aim of the privatization process was to enhance substantially the efficiency of the enterprises and during the course of which diverse patterns of privatization were adopted, case-by-case method adopted and valid ownership contributions were sought. Privatization is said to have a depoliticization effect on the economy also surfaced, which has been described by Tomasz Mickiewicz as: '

Depoliticization -----→ Market Driven Restructuring ----→ Microeconomic efficiency

The privatization related legislation has proved highly efficient, although concerns have been voiced about the organizational aspect of it[28]. Independence of the privatization agency and its ability to function in

[27] Mickiewicz, op. cit., 435.
[28] Ibid., p.436.

exclusion of the state budget has come drawn criticism. This was an attempt to enable the revenue and cost of privatization to be excluded from the strict regulations governing public funds. The other problems that still persist are disposal of unwanted property, insuffcient utilization of personnel and financial resources involved in carrying out the privatization process.

Privatization Scoreboard

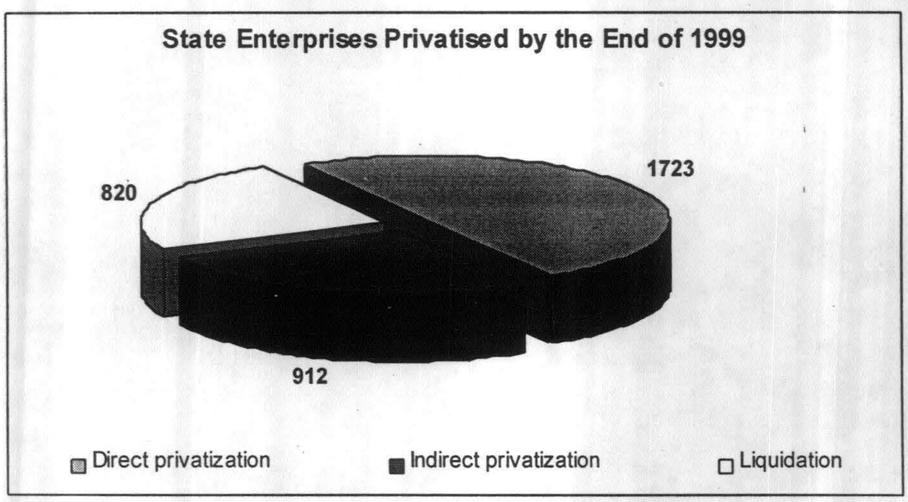
At the beginning of privatization in mid-1990, there were 8441 SOEs in Poland. By mid-1999, the number of SOEs had decreased to 1610 functioning firms. Around 759 were undergoing bankruptsy procedures and the privatization was initiated or completed in 6510 firms. [29]

- 1399 companies were corporatized, out of which 250 were capital privatizations and 512 were mass privatizations.
- 1723 companies came under the direct privatization program.
- 1575 firms were completely privatized. 68 percent through employee leasing, 21 percent through direct sales and 8 percent by contribution of assets to a new company and 3 percent by mixed forms of privatization
- 820 companies were liquidated under genuine liquidation program.
- All 1662 state farms were liquidated by 1995 and the land either sold or leased.
- Of all the privatized, 48 percent were in the manufacturing sector, construction came in as the second largest sector with 17 percent.

[29] Mickiewicz, op.cit, p. 402.

- Corporatization was hardly used in trade and transport sectors, though massively in manufacturing – 73 percent. It was used in a limited way in construction - 10 percent.
- The share of private sector in gross value added was 70 percent. Foreign firms accounted for 5 percent of the total and domestic owners 56 percent.
- The private sector provides around 74 percent employment.
- The share of private sector in investment is 58 percent, proving the faster rate of capital accumulation[30].

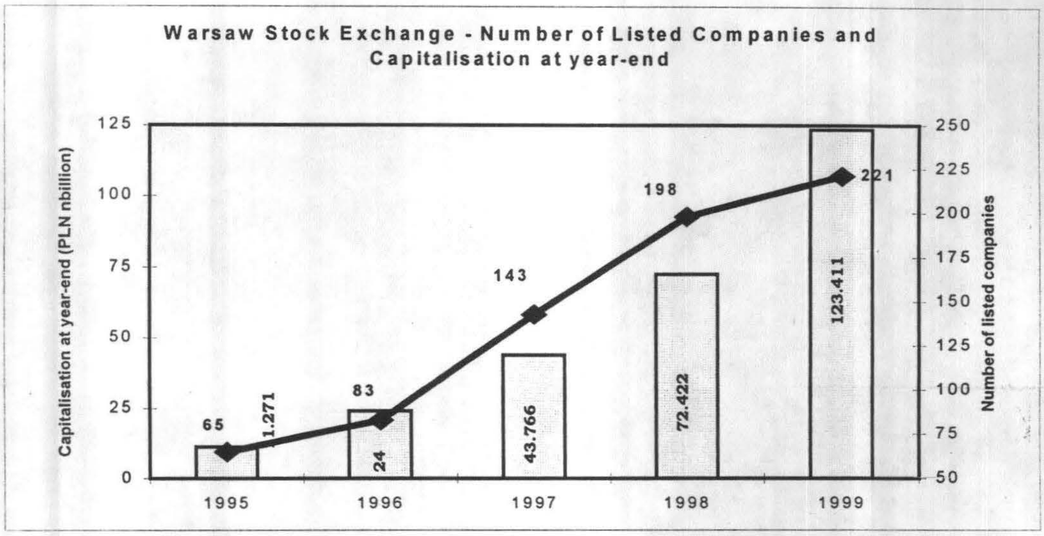
Figure 3.1



Source: http://www.paz.gov.pl.

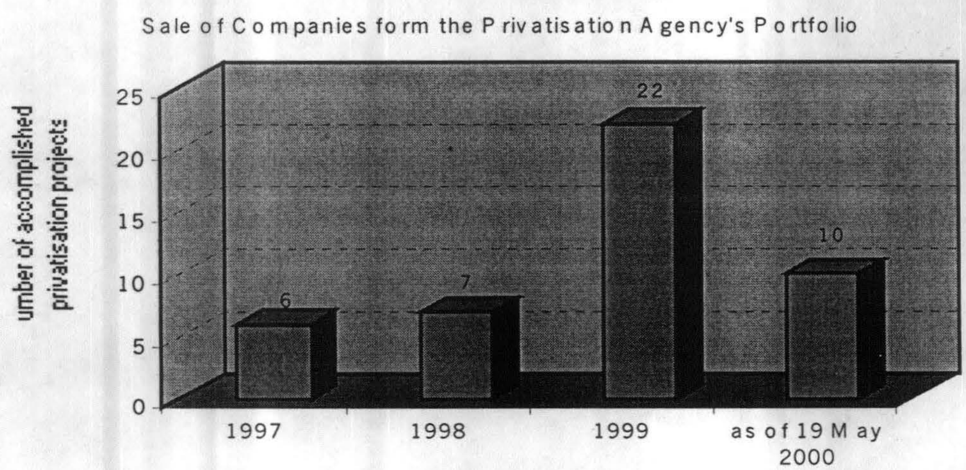
[30] ibid., p. 408.

Figure 3.2



Source: Embassy of Republic of Poland in India, New Delhi.

Figure 3.3



Source: same as 3.2

Poland has come to cover a decently long way in a bid to step up the privatization initiative and the results easily prove that 'well begun is half done'. Privatization in Poland is of prime significance not only to the nation and its people but also to foreign investors, neighboring countries, international organizations and observers at various levels. Since 1998, a great deal of activity has been observed in the sphere of privatization. Majority of the sectors of the economy have been restructured, privatized and transferred to private hands. Private sector accounts for almost 70 percent of the total value-added. Not only efficiency levels of the privatized companies has gone up, they are also bidding for upper-end, high technology products and services, underlining the move to move to international competitive markets. Efforts to step up privatization bid in insurance, energy, telecommunications sectors need to be accelerated. The government has formulated a privatization strategy until 2001, which calls for selling 70 percent of the state assets through various channels[31]. Stakes in state enterprises have also been set aside to finance the partial restitution of properties to owners expropriated between 1944 and 1962. A draft bill in the Parliament also proposes legal framework for the process.

Privatization is a complimentary to a whole range of transitionary macro and micro-economic measures that facilitate private ownership and competition and Poland has carried out the entire process in a democratic and pluralistic manner. It has also created a new breed of owner-managers, who are willing to do what it takes to build highly competitive firms from the remnants of state industries. They have the potential to emerge as world class players and build Poland into a truly competitive, enterprising nation.

[31] http://www.oecd.org/eco/sur/esu-pol.htm

Economic Integration with EU and World

Introduction

The key to strong economic performance lies in integrating with the world economy. All successful economies over the past two decades have based themselves upon export-oriented policies and declining barriers to exports. The foreign trade sector in top performing economies forms a significant chunk of the economic output. Poland by this means cannot be an exception. It recently witnessed some top growth rates in entire Europe. Its historically acclaimed stabilization cum transformation programme did the groundwork for opening up the economy. Developments to the external economy sector have had a bearing on the overall economic output and shall continue to do so.

When Poland embarked on its expedition to transform its economic fraternity and orientation, one of the key desires that preponderated was to develop firm links with the countries of Western Europe and explore the expanse of economic and trade ties further, for the purpose of economic development and mutual ascension. A particular sense of relief dawned upon the nation, when the two of the most important organizations that bound them to their communist past and carried the legacy of the centrally planned system - COMECON and the Warsaw Pact, collapsed in the early 1990's. It was also viewed as a vanguard for opening up new avenues and possibilities in foreign trade. There also existed a sense of relief on waning away of the Soviet supremacy, which had continued to dominate the precept of foreign trade for a long time. Although economic and political instability in neighboring nations likes Russia, Belarus and Ukraine, seemed to be a cause of concern for a while[1].

External Economic Ties under the Centrally Planned Economy

Foreign economic relations under the Centrally Planned Economy (CPE) were determined largely by ideological considerations rather than mutual economic benefit. Council for Mutual Economic Assistance (CMEA) was the harbinger of all the nations representing the Soviet bloc of countries and trade within the CMEA accounted for majority of the foreign trade for each nation, including Poland. Soviet Union was Poland's largest trading partner till the time CMEA was dissolved in 1992. The commodity composition of trade was also heavily tilted towards producer goods and defense equipment rather than consumer goods. Trade with CMEA and particularly the Soviet Union seemed to be an attractive option for countries within the block in terms of exchanging manufactures in exchange for cheap energy. However, the other side of this arrangement showed that much of the exchange consisted of Poland exporting energy-intensive and technologically outdated, low quality products in exchange for energy, primarily oil. A portion of imported oil was thus shipped back to its supplier. Owing to its low-quality requirements by importers from supply-constrained economies, the Soviet market was a

[1] http://www.eia.doe.gov/emeu/cabs/poland.html

dumping ground for manufactured goods, thereby eliminating incentives to emphasize efficiency and innovation [2]. This pattern of trade coupled with the inward orientation of the CPE proved to be damaging for the Polish economy and its ability to compete in an international economic field. During the 1980's the high technology content of manufactures fell in comparison to the 1970's. Despite the efforts to modernize during the Gierek era during the 1970's, Poland's competitive position as measured by annual changes in its share of imports by Western nations, dropped significantly during the 1980's. Not only this, Poland's comparative advantage remained in food and natural resource-intensive products, which reflected its declining position on high-end technology products. Lack of private sector initiative and absolute state monopoly on foreign trade added to the laggard performance by Poland.

Poland's Attempt to Reintegrate with World Economy

Poland has made some impressive strides in reintegrating with the world economy in general and the EU in particular; its economy reflects a certainly high degree of openness, than its past record under the centrally planned regime.

Since 1989, there has been a marked shift in the trends and policies of the Polish foreign trade. While the geographical move has definitely been towards the EU, the commodity composition of trade has tended to incline towards the manufactures. Foreign Direct Investment inflow, after a sluggish beginning during the early transition years has now begun to cast a brighter

[2]Kaminski, Bartlomiej, "Foreign Trade: Policies and Performance," *Transition to Democracy in land,* New York: Red Starr, 1997).

outlook. An equally positive impact seems to be reflected in trade, technology transfer and know-how.

The possible threats to sustain a good foreign trade performance lie in slow progress, reversal in institutional reform and state interventionism. The Uruguay round of talks stipulate lowering of barriers to trade in export markets and the Association Agreement provides for duty-free access to the Polish markets, though in restricted categories. Any slackness on the institutional front is worrysome, owing to the growing competition in both the domestic and exports' markets.

At a time when production and capital markets are globalized, foreign trade is no, longer the only linkage between domestic and world economies. Other linkages include inflow and outflow of financial assets, capital in form of direct investment and international labor mobility. The stabilization programme, which was introduced on January 1, 1990, paved a way for growth of the foreign trade sector. It removed the major obstacles that hindered firms from direct exposure to international markets. The development of capital markets, the removal of various legal barriers to the development of private sector and the convertibility of the *Zloty* has enabled inflows of the foreign capital. All these factors put together have made it possible to facilitate integration of the Polish economy with the rest of the world.

Poland has a fair track record in the field of international co-operation. It has been a member of General Agreement on Tariffs and Trade (GATT). It took part in the negotiations of the Uruguay round and presented tariff concessions with GATT member nations and also signed the final protocol of the Uruguay round. Poland has also joined the World Trade Organization (WTO) and adjusted its foreign trade regime to the requirements of the WTO membership. International trade treaties signed largely determine customs duties in Poland. These include EU Association Agreement, EFTA, CEFTA and a few bilateral agreements and undertakings within WTO. In December 1999, the Council of Ministers issued an ordinance adopting a new customs' tariff.[3]

Patterns in Polish Foreign Trade

Dismantling of the centrally planned structures has had a strong bearing on the patterns in foreign trade. The unification of exchange rates combined with current account convertibility has brought international markets to bear directly on the domestic producers and consumers. The response to the entire maneuver has been good and the two-way interaction has positively affected Poland's economy. Foreign trade has provided a boost to recovery and export earnings financed the expansion in imports. Imports in return have provided high quality products, both for consumption and investment. This combined with competition from imports has stimulated local producers to improve their performance[4]. Foreign transactions (calculated by dividing the sum of exports and imports by two) account for

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[3] http://www.polandtoday.com/eco/0013.html

[4] Kaminski, Bartlomiej, "Poland's Transition from the Perspective of Performance in EU Markets," *Communist Economies and Economic Transformation*, Volume 10, No. 2, 1998, p. 182.

almost 20 percent of the Polish GDP. However, it is yet a figure way behind the standards set by any market economy of a similar stature in terms of development levels, size of the economy and GDP growth.

One of the noticeable trends of the post-communist Polish foreign trade is the geographical shift in the pattern and direction of trade orientation. The EU accounts for almost two-thirds of Poland's total trade, which is a drastic rise from the 32 percent level of the 90's. By this dimension, Poland is more integrated with the EU, than several other member nations. Germany has replaced the former Soviet Union as Poland's largest trading partner. Its share rose from 15 percent in 1989 to 30 percent in 1996[5]. By end of 1999, Germany has continued to dominate at least a quarter of the Polish foreign trade. The EU continues to share nearly 68 percent of Poland's foreign trade on the whole, by end of 1999. At the same time, the share of the former Soviet Union and now Russia continues to dwindle. Once, the largest trading partner, with a whopping 40 percent of the trade pie, Russia now shares a dismal 4.2 percent of the trade share[6]. The Russian economic crisis is considered as a major deterrent to trade ties between the two nations.

Industrialized nations account for majority of the Polish exports and imports, with the respective figures standing at 77 percent and 74 percent approximately. Eastern and Central European nations amount to 17 percent of exports and 14 percent of the imports from Poland. Developing nations account for about 7 percent of exports and 12 percent of imports. The trend

[5] Ibid. p. 219.
[6] As per the data disseminated by the Economic and Commercial Wing, Embassy of Poland in India.

shows that overall trade with industrialized nations has increased significantly, whereas the trade turnover with East and Central Europe and former Soviet Union has decreased during the last few years.

Machinery and transport equipment dominate both exports and imports, with an approximate share of 30 percent and 38 percent respectively. Manufactured goods follow the league, sharing nearly quarter of the exports' pie. On an overall, the trade balance is in a negative, however there are commodity groups, which are generating surplus. They include furniture, clothing, ships, semi-processed goods and meat.

The accounted trade deficits are largely explained, as a necessity for the economy, since most of them are raw materials and investment goods, required for industrial restructuring and development. Petroleum, motor vehicles, computers, electronic integrated circuits and engines account for the next league of imports.

The role of private sector in furtherance of foreign trade has been commendable. Its role has risen from 42 percent in 1993 to 81 percent in 1999 for exports and stands at 87 percent for imports, when compared to the 1993 figure of 60 percent.[7] With de-monopolized trade structures now, the response from the private sector to engage in import-export activities has been immense. In 1999 itself, there were nearly 42,000 Polish enterprises engaged in trading with foreign partners at various levels. The share of small and medium enterprises in the whole picture has also been on an upscale,

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[7] Ibid.

accounting for nearly 52 percent of the foreign trade. However, the largest 100 Polish exporters accounted for 40 percent of the exports in 1998-99[8].

The Polish current account balance of payments has been negative for several years. However, analysts discount it, owing to the strong position on capital account. The foreign exchange reserves have been rising constantly. In 1994, they went up by USD 1.7 billion to USD 6 billion and increased by as much as USD 9 billion reaching USD 15 billion in 1995. In December 1998, the foreign reserves amounted to USD 27.4 billion and 26 billion a year later. This growth has widely been attributed to cross-border trade, foreign direct investments, short-term capital operations and foreign exchange portfolio.

Foreign Debt

The post-Communist Polish economy inherited a massive legacy of debt, which was an added liability to the economic reform process. At the end of 1993 foreign debt amounted to USD 47.1 billion and had been stable since 1990, when it stood at USD 48.5 billion. This stabilization was an aftereffect of an agreement reached on April 21, 1991 to reduce Poland's debt of USD 33 billion due to the Paris Club [9]. After this agreement came into effect, Poland had to pay only 20 percent of the interest due for 3 years until 1994. These payments amounted to USD 600 million in 1991, USD 470 million in 1992 and USD 520 million in 1993. An additional amount of USD 59 million interest on debt was paid to the London Club, i.e. commercial banks in 1993. Under the

[8] Ibid.

[9] *Economic and Business News from Poland*, November 2000, Published by Embassy of Poland in India, p. 25.

April 1991 agreement with the Paris Club, implementation of the whole programme drafted in consultation with the IMF paved the way for a 50 percent debt and rescheduling till 2009. The creditor countries had a choice of a reducing the principle of the debt or interest. USA, Germany, UK, the Netherlands, Finland and Sweden chose forgiveness of the principal.

Another 11 countries, including Austria, Belgium, Brazil, Canada, Denmark, France, Italy, Japan, Norway, Spain and Switzerland reduced the interest rate and extended the pay back date till 2014.

Table 4.1
Imports By Origin, 1980 -98
(USD billion and percent)

	1980	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total (US$ billion)	19.1	8.2	15.5	15.9	18.8	21.4	29.0	37.1	42.3	47.0
				(Per cent of total)						
America	9.2	2.7	3.2	5.0	6.7	5.3	5.8	6.8	6.6	5.7
United States	4.0	1.6	2.3	3.4	5.3	3.5	3.9	4.	4.5	3.8
Canada	1.4	0.1	0.2	0.4	0.4	0.3	0.4	0.5	0.4	0.5
Other America	3.8	0.9	0.7	1.2	1.0	1.5	1.5	1.9	1.6	1.4
Europe	81.4	87.2	85.4	83.7	82.9	`82.2	84.1	82.5	81.8	82.1
EU15	30.9	51.4	59.0	62.0	64.8	64.0	64.7	64.0	63.9	66.126.5
Germany	13.4	20.1	26.5	23.9	28.1	27.3	26.7	24.7	24.1	9.4
Italy	2.0	7.5	4.5	6.9	7.8	8.3	8.6	9.9	9.9	9.5
France	4.2	3.0	3.6	4.4	4.3	4.4	4.9	5.5	5.9	4.9
United	3.5	5.7	4.0	6.6	5.8	5.1	5.2	5.9	5.5	3.8
Kingdom	1.1	2.6	4.9	4.8	4.7	4.5	4.5	3.8	3.6	29
Netherlands	1.3	2.0	1.8	1.9	2.2	2.7	3.1	2.7	3.0	2.2
Sweden	2.3	7.9	5.5	4.2	8.6	6.4	3.1	2.5	2.5	12.9
EFTA	46.3	25.2	19.0	16.3	13.4	13.4	15.4	15.2	14.6	6.9
East Europe	33.1	19.8	14.1	11.8	936	9.6	9.6	9.5	8.6	5.0
Former USSR	..	..	..	8.5	6.7	6.7	6.8	6.8	6.4	1.0
Russian	1.9	2.7	1.9	1.3	1.0	1.0	0.8	0.8	0.9	11.0
Federation	5.5	8.5	10.7	10.1	8.9	7.9	7.9	9.2	10.2	0.2
Other Europe	2.6	3.1	4.1	3.1	1.9	1.0	1.0	0.3	0.4	10.1
Asia	2.5	4.8	6.1	6.4	6.4	6.4	6.3	8.3	9.3	0.5
Middle East	0.5	0.6	0.6	0.5	0.6	0.6	0.5	0.5	0.5	1.1
East Asia	1.9	0.5	0.4	1.2	1.4	1.4	1.4	1.3	1.2	0.1
South Asia	1.9	1.0	.3	0.1	0.2	0.2	3.2	0.2	0.2	
Africa										
Other										

Source: *Trade Policy Review: Poland 2000*, Geneva: 2000, World Trade Organization.

Table 4.2
Exports By Group of Products 1990-98

	1980	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total (USD billion)	17.0	13.6	14.9	13.2	14.0	17.2	22.9	24.4	25.7	28.2
Total primary products	29.4	35.8	39.6	40.0	32.1	31.8	28.5	25.7	27.0	22.6
Agriculture	8.9	15.8	20.0	18.1	14.3	14.8	13.2	13.	14.5	12.6
Food	6.4	12.7	14.7	13.9	11.1	11.6	10.4	110.8	12.3	10.6
Mining	20.0	20.0	19.7	21.9	17.8	17.0	15.3	12.6	12.4	10.0
Ores and other minerals	2.4	2.6	2.9	4.0	2.2	1.4	1.3	1.1	1.0	0.7
Non-ferrous metals	4.8	6.7	6.1	7.3	6.7	6.6	6.0	4.8	4.9	3.9
Fuels	13.2	10.7	10.7	10.6	8.8	8.9	8.0	6.8	6.6	5.4
Coal, excluding briquettes	9.2	9.2	6.2	6.9	6.8	6.1	5.4	4.7	4.4	3.4
Manufacturers	60.7	59.1	55.4	59.1	66.1	67.9	71.1	74.2	72.9	77.2
Iron and Steel	3.7	6.9	7.3	7.6	7.2	7.1	6.2	5.5	5.7	4.5
Chemical s	5.2	9.1	9.2	8.7	6.7	6.8	7.8	7.7	7.8	6.7
Other semi-manufacturers	3.9	7.3	9.5	10.4	10.9	12.1	13.6	13.8	13.9	14.6
Machinery and transport equipment	36.0	26.1	18.5	19.2	20.6	19.8	21.1	23.5	21.6	28.4
Power generating machines	1.5	2.0	1.7	0.7	0.5	0.4	0.7	0.7	0.5	0.5
Other non-electrical machinery	15.8	7.7	4.3	4.4	4.0	4.2	4.5	4.8	5.0	5.3
Office machines & telecommunications equipment	2.4	2.3	0.8	0.7	1.0	1.3	1.8	2.3	3.1	4.0
Other electrical machines	4.4	3.7	3.2	4.4	4.0	3.8	4.0	4.7	5.1	5.9
Automotive products	4.9	2.7	1.2	3.8	5.2	4.4	4.8	5.4	5.9	7.0
Passenger motor vehicle Excluding buses	..	..	..	2.0	3.9	3.0	2.9	3.2	3.0	3.6
Other transport equipment	7.1	42	3.9	4.9	5.9	5.8	5.3	5.6	2.0	5.6
Textiles	2.7	2.0	1.6	2.0	2.1	2.2	2.1	2.2	2.5	2.6
Clothing	3.8	2.7	3.4	5.0	11.3	10.8	10.1	9.8	8.7	8.6
Other consumer goods	5.3	4.9	5.9	6.2	7.3	9.1	10.1	11.7	12.7	11.9
Furniture	1.0	1.5	2.4	3.1	4.1	5.2	5.9	6.6	6.9	6.8
Other	0.1	5.1	5.0	0.9	02	0.3	0.4	0.1	0.1	0.2

Source: Same as table 4.1

Table 4.3
Balance of Payments on Current Account (USD million)

	1993	1994	1995	1996	1997	1998	1999
Current Account	-2,329	-944	-2,101	-1,352	-4,268	-6,810	-11,569
Export revenue	13,585	16,950	22,878	24,420	27,229	30;247	26,347
Import expenditure	15,878	17,786	24,705	32,574	38,497	43,914	40,727
Balance	-2,293	-836	-1,827	-8,154	-11,269	-13,667	-14,380
Services net	369	57	150	-209	305	-511	-1,624
Income net	-3.524	-2,228	-747	-422	-465	-571	-804
Transfer net	3,019	1,916	204	224	1,110	1,943	1604

Source: Embassy of Republic of Poland in India, New Delhi.

Table 4.4
Imports by Group of Products 1980-98

Commodity	1980	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total (USD billion)	19.1	8.2	15.5	15.9	18.8	21.4	29.0	37.1	42.3	47.0
	(Per cent of total)									
Total primary products	43.0	37.2	37.1	34.2	28.8	26.9	25.2	24.7	22.2	18.6
Agriculture	19.1	10.8	15.7	14.2	13.5	13.5	12.8	12.8	10.7	9.7
Food	14.0	7.7	13.1	11.5	10.6	10.6	9.6	10.1	8.3	7.7
	5.1	3.2	2.7	2.6	2.9	2.9	3.2	2.6	2.4	2.0
Agricultural raw material	23.8	26.4	21.4	20.0	13.4	13.4	12.4	11.9	11.5	6.9
	4.3	3.3	2.0	2.5	1.9	1.9	1.9	1.6	1.5	1.3
Mining	1.4	1.1	0.5	0.8	1.0	1.0	1.3	1.2	1.2	1.3
Ores and Other minerals	18.1	21.9	18.9	16.8	12.4	10.5	9.2	9.2	8.7	6.3
Non-ferrous metals	51.0	62.8	62.6	64.7	69.6	73.1	74.4	75.0	77.6	80.4
Fuels	6.2	4.2	1.3	2.0	2.3	2.6	3.2	2.9	2.7	3.2
Manufactures	7.6	8.6	9.5	13.2	12.9	14.5	14.6	13.4	13.5	13.3
Iron and Steel	4.0	4.0	6.2	7.2	7.7	8.8	9.7	9.8	10.1	10.5
Chemicals	27.4	34.5	32.7	29.7	29.4	29.2	30.1	33.2	36.1	38.1
Other semi-manufactures	0.7	0.9	0.7	0.3	0.4	0.5	0.5	0.4	0.4	
Machinery and transport										0.4
equipment	13.8	16.0	9.5	12.7	10.7	11.4	11.2	11.6	11.8	12.2
Power generating machines										
Other non-electrical machinery	2.0	1.1	0.5	0.4	0.3	0.4	0.5	1.8	0.8	0.5
Agricultural machinery and tractors	2.2	5.3	8.6	6.6	6.8	5.9	6.1	6.7	7.1	7.9
Office machines & telecommunications	2.2	2.7	2.5	4.1	4.7	5.0	5.3	5.6	5.6	5.9
Equipment	6.2	3.5	6.4	5.0	6.2	5.7	6.2	7.9	9.7	10.5
Other electrical machines	2.3	1.3	1.1	0.7	0.5	0.8	0.8	1.0	1.6	1.0
Automotive products	1.6	2.1	1.7	1.9	7.2	7.4	7.4	6.3	5.7	5.8
Other transport equipment	0.8	1.8	2.6	1.2	1.3	1.1	1.1	1.2	1.2	1.3
Textiles	3.4	7.5	8.7	9.4	8.7	8.3	8.3	8.2	8.2	8.2
Clothing	0.1	0.0	0.3	1.1	0.1	0.5	0.5	0.1	0.3	1.1
Other consumer goods										
Other										

Souce: http://www.eia.doe.gov/emeu/cabs/poland.html

Foreign Investment in Poland

Foreign Direct Investment (FDI) has been one of the main driving force behind the growth of the Polish economy. At the end of 2000, the total inflow of FDI into Poland totaled USD 40 billion. This was the highest level received by any East European country since the collapse of the erstwhile USSR. As a result, Poland has been termed as the fastest growing economies in the region.

The Polish Agency for Foreign Investment (PAIZ) is the prime organization, which is bidding to promote Poland as a desirable investment destination for foreign investments. PAIZ enjoys commendable political support. National as well as local politicians from the left and right factions alike endorse its efforts. Investments over 1 million are monitored by PAIZ and amounted to around 36 million. An investment commitment of more than 13 million is also in the pipeline.

In 2000, real GDP growth stood at 4.3 percent, which has been termed as a fair rate of growth, in comparison to the neighboring East European countries. For example, the Czech Republic registered a rate of 2.2 percent. The Polish GDP per head, which stood at USD 6,870 in 1998, is expected to touch USD 8,170 by end of this year. High FDI inflow is being viewed by economists and analysts as a significant factor in boosting prosperity and living standards. According to recent PAIZ estimates, if FDI levels are sustained at USD 6-9 million per year, for the next five years, GDP per head will rise to over USD 10, 000 by 2005. Lack of the same investment is expected to spell trouble for the economy, with slow growth and entrepreneurial levels not far behind. The top investors, US, Germany and France could also step back in case the Polish economy shows signs of closing up and restrain. The Economist Intelligence Unit has given Polish policy towards foreign investment a rating of 8.3 on a 10 point grading system. This puts Poland at the 20th position out of the 60 developing and emerging economies.

According to investor research by PAIZ, Poland's attractiveness to foreign investors lies in its big domestic market, quality and low price of its workforce coupled by the fact that other economic parameters match up to the best the region.

In 1999, Poland received a direct foreign investment of USD 8.3 million, marginally lower then the 1998 figure of USD 10 million. Poland continues to maintain its leading position in Central and Eastern Europe pocketing 36 percent of the FDI flow that come to the entire region[10]. One of the interesting features of the foreign investment in Poland is the fact that the companies already well-established in Poland usually reinvest most of the profits generated in the country to support and develop local operations.[11]

It is worth noting that Poland is also exporting capital at a very small level though. According to latest UNCTAD estimates, Polish companies invested about USD 200 million in 1998, bringing the total value of Polish foreign investments to about USD 841 million.

[10] http://www.unido.pl

[11] *How to do Business in Poland*, 2000, Investment and Technology Promotion Office, UNIDO, Warsaw.

Poland's slated accession to the EU in 2004 is another drawcard to attract investment. The EU accession is expected to draw up rigorous taxation and customs' law besides extending psychological security to foreign investors, who know that EU membership will speed up the process of reform and modernization of infrastructure - specially in sectors like roads, railways, transportation and shipping.

Joining the EU is certainly not without its own set of rules. This is bound to extend its implications on FDI inflow into the country. Even now as Poland prepares to join the EU, the EU headquarters is already in process of imposing rules on Poland. In order to meet the EU limit on investment, the government has been forced to bring in rules, which cap the amount of state aid that can flow to inward investors in Poland's 15 Special Economic Zones (SEZs). PAIZ is now focussing on country's natural advantages as an investment destination, such as large population rather than cash incentives to draw in investors.

Another hinge in way of luring FDI is to bring the huge agricultural population in calibration with the emerging industrial growth. It has to be insured that the workforce perspectives keep up with the investment inrush. Over a quarter of the Polish population is still employed as a part of the agricultural workforce and contributes a meager 6.4 percent of the GDP. Foreign investment traditionally finds its locales in urban areas and prime cities but Poland's huge agrarian workforce is the most important reason that it cannot absorb as much FDI per head as its Central European neighbors.

Poland gets more FDI in absolute terms but its stock of FDI per person is less then USD 1000; which compares poorly with USD 2000 in Hungary and USD 1, 750 in Czech Republic[12].

Poland and International Organizations

The role of international economic organization in assisting Poland's transition is absolutely undeniable. These include the World Bank (WB), the International Monetary Fund (IMF) and the International Finance Corporation (IFC), with whom Poland had come to establish good ties, way back in 1980[13].

During the prime task of preparing and implementing the coveted stabilization programme in 1989-90, the IMF arranged for a stand-by loan to support the Polish currency. Not only this, these institutions provided Poland with requisite expertise.

Poland rejoined the World Bank in 1986 and its lending to Poland started in 1990. Since then the bank has committed almost USD 5 billion, for 31 operations and projects in Poland. About USD 2.9 billion of this amount has been disbursed and USD 712 million repaid by September 1999. [14]

The World Bank has provided three main types of loans to support the government's economic development programme. They are: fast disbursing programme assistance to help offset some costs of economic reforms to the budget and balance of payments, lending for specific investments such as

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[12] EuroBusiness May 2001, p.120.
[13] http://www.imf.org/pubs/cat/doctext.cfmWP/93/42-EA
[14] *Economic and Business News from Poland*, November 2000, Published by Embassy of Poland in India, p. 49.

equipment for infrastructure rehabilitation and financing of modernization and expansion projects by private enterprises through credit lines managed by Polish banks. In 1999 the World Bank approved USD 300 million of loans for Poland. The approval of USD 2.5 million loan for National Environment Protection Fund has been one of important fund disbursement for the year 2000. The other loans included USD 32.8 million loan for Geotermia Podhalanska to finance Geothermal Heating Project in Zakopane area and USD 120 million loan for rural development project. Both the loans are expected to be signed soon[15].

Poland and the European Union

Poland is regarded as a giant among the Eastern candidates for European Union (EU) membership, owning to the consistent work of all the post-communist governments of the nation. Moreover, the extant consensus among the domestic political forces, despite a few dissenting voices and the focus of Poland's policy towards the EU accession is undeniable.

Work towards EU membership has proceeded to such an extent that the quest for EU membership has remained a consistent pillar of Polish foreign policy across all post-communist governments. A closer examination of some documentary evidence reveals this consistency in policy since 1989 and identifies Poland's goals in seeking entry to the EU[16].

Although a varying degree of responses do exist on the pace, tempo and degree of Polish integration with the Union, the official stance and the

[15] http://www.worldbank.org/poland/fin/00dev/.html
[16] http://www.ce-review.org/0018/riedel118.html

general opinion indicating a pro-European stance does exist across the board. Poland began accession talks in 1998 and has provisionally completed negotiations on nine legislative chapters, with six remaining open. Agriculture, environment and freedom of movement are a few key areas to be negotiated.

The President, according to the Constitution is the highest representative of the Republic of Poland, especially on foreign policy issues.

By virtue of its spectacular progress in economic reforms and its enthusiastic desires to join the Western structures, Poland has always been regarded as a leading candidate for quick entry into the European Union. In 1997, Poland received an invitation to join NATO. This procedure was completed by March 1999. Already being a member of NATO, Poland has come to set a target date of January 2003 for accession to the EU. It is one of the five Central and East European "front runners" that have been negotiating with the European Commission for enlargement in Brussels for the last two years. The other Central and East European candidates for the EU membership are Hungary, the Czech Republic, Estonia and Slovenia[17].

Accessing the accession

The formal process of accessing the EU was formally launched by the foreign ministers of the 15 EU candidates on March 30, 1998. These nations include the Central and East European nations of Hungary, Poland, Romania, Slovakia, Latvia, Estonia, Lithuania, Bulgaria, Czech Republic, Slovenia and

[17] http://www.rferl.com/nca/features/2000/04/F.RU.000404122521.html

the Mediterranean nations of Turkey and Cyprus. Prior to this meeting of the foreign ministers, country-specific accession partnerships were adopted to support the applicant countries in their preparations for membership. These programs set out the priorities for further work and provided for supporting financial assistance from the EU. In May 1998, Poland presented the first version of a National Program for the Adoption of Acquis, (NPAA)[18], which described in greater detail the actions, needed to reach the objectives spelt out in the accession partnership. In the following Inter-governmental Conference, a year later, Poland presented the main elements of its integration strategy in the opening session of the EU-Poland accession negotiations in Brussels on March 31. An analytical analysis of the acquis started on April 3 and it was decided that the pre-accession aid will be increased substantially. Along with the existing PHARE aid, it was decided that from the year 2000, Poland will receive aid for agriculture and a structural instrument. The PHARE programme is expected to aid institution building and investment areas.[19]

Economic Criteria

In its 1997 notification on Poland's application for EU membership, the European Commission report concluded: "Poland can be regarded as a functioning market economy ... (it) should be well able to cope with competitive pressure and market forces within the Union the medium term."

While examining the economic developments in Poland, the Commission's orientation was guided by the conclusions of the European

[18] Regular report 1998 from the European Commission on Poland's progress towards accession, p.6.
[19] Ibid.

Council in Copenhagen in June 1993, which stated that membership of the Union requires:

- The existence of a functioning market economy;
- The capacity to cope with competitive pressure and market forces within the Union. Reforms taking place within the framework of the EU accession process is bound to have a significant impact on the Polish economy. Poland has already achieved a considerable degree of integration with the EU, where EU is its largest trading partner and brings in about two-thirds of the inward investment. Removal of barriers to movement of goods, services, and factors should further benefit Poland through increased domestic competition and improved access to the Single market.

Poland's Trade Policy Regime

Poland's foreign trade policies and orientation in recent years has been motivated mainly by the desire to join the European Union. This has come to forge a fresh opportunity for economic reform and modernization of domestic institutional framework. Poland is already negotiating for accession to the EU and has redirected its policies and practices to suit the process. It also has strong ties with neighboring Czech Republic, Hungary, Slovakia through its membership in the Central European Free Trade Agreement (CEFTA). The newer members to the group are Slovenia, Bulgaria and Romania. Poland has very recently concluded bilateral free-trade agreements with the Baltic States (Latvia, Lithuania and Estonia), Israel and Turkey. Poland's trade under the free-trade agreements accounted for almost three-quarters of its merchandize trade in 1997 and EU stands as its largest trading partner[20].

Poland's economic and trade policy formulation has changed since the previous review in 1992. The responsibilities of several ministries have been transferred to the Ministry of Economy, which plays the role of main policy-setting body in Poland and is responsible for trade, economic and industrial policies. The Ministry of Economy initiates the policy and decisions of the Council of Ministers on foreign economic relations, including the inflow of foreign capital, agreements on mutual protection of investment, tariff and non-tariff policies and regulation of foreign trade. It also undertakes and develops bilateral and multilateral relations, secures improved access to foreign markets and co-operates with various organizations. Initiating, overseeing and implementing export and industrial policy also come under its purview.

The ministry also evaluates economy's situation and effectiveness of economic policies.

The other prominent ministries in setting trade and economic policies are the Ministry of Finance and the Ministry of Treasury, which has taken over the Privatization Program since 1997[21].

Excise and trade taxes are set the Ministry of Economy in consultation with the Ministry of Finance and the Central Board of Customs implements

[20] *Trade Policy Review: Poland 2000*, Geneva: 2000, World Trade Organization. p.19.
[21] Ibid. p.20.

them. The Foreign Investment Agency monitors and promotes inward investment.

Poland's trade laws and regulations have undergone considerable change since 1992 and the accession to EU has been kept as a requisite, while framing these laws. In order to access the EU Poland needs to adapt about 7000 acts. Poland's main laws covering trade and trade related polices have been summarized in Table 4.8.

Poland joined GATT in 1967 and became a founding member of the WTO on 1 July, 1995. The Uruguay Round Agreements were ratified by the President of Poland under legislative authority granted by the Parliament. They are a part of domestic legislation and take precedence over domestic laws, where they do not conform[22]. Poland's main commitment on trade to the Uruguay Round were:

- Bind for the first time, close to 94 percent of its tariffs.
- Reduce tariffs by 38 percent on industrial products and 36 percent on agricultural goods over six years.
- Limit domestic support to agriculture by 20 percent in value terms by the year 2000 and cut agricultural export subsidies by 36 percent in value and 21 percent in volume.

In services, Poland made a number of commitments under the General Agreement on Trade in Services (GATS). Commitments were made in ten sectors: business, services, communications, construction, distribution,

[22] http://www.wto.org/WT/DS19/2.htm.

education, environment, financial services, health care services, tourism and transport services[23].

Poland also participated in the 1997 Information Technology Agreement (ITA) and agreed to eliminate tariffs by 1 January 2002 on a range of imported information technology products. Poland has also extended Generalized System of Preferences (GSP) to 45 developing countries with a lower per capita GDP than itself and to the 49 least developed countries. Except for certain sensitive items, imports from developing countries are dutiable at tariff rates equivalent to 70 percent of the MFN level. Imports from LDCs are duty free[24].

Poland has recently concluded many bilateral agreements aimed at protecting foreign investors. They generally provide for symmetrical obligations and include provisions such as national treatment, expropriation and compensation rights, transfer of capital, intellectual property rights and settlement of disputes. In a lot of cases these agreements are complemented with double taxation agreements, further enhancing the private sector investment environment.

Poland is committed to introduce the TRIPS Agreement by 2000, and under the Europe Agreement, to provide intellectual protection and enforcement similar to the EU. It has a patent, trademark and copyright legislation broadly consistent with international standards. A new industrial property law is also on the anvil.

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[23] Ibid.
[24] Trade Policy Review, op.cit. 34.

As we have noticed, Poland has made some landmark strides in integrating its economy with the rest of the World, particularly the EU. However, lots more needs to be accomplished. A consistent trade policy and a high level of initiative to boost competitiveness in the world market are bound to go a long way in proving its credentials. Transparency in international dealings and fair trade practices coupled with strong institutional framework will ensure that Poland achieves its goal of being at par with the top performing world economies.

Table 4.5

Foreign Investment by Source and Activity 1993-98

Foreign direct investment net (USD million)	1993	1994	1995	1996	1997	1998
Portfolio investment, net (USD million)	580	542	1,134	2,741	3,041	6,164
Total (USD million)	0	-624	1,171	241	2,098	636
Total as a per cent of GDP	580	-82	2,305	2,982	5,139	6,800
Foreign direct investment inflows by country (percent of total)[a]	0.7	-0.1	1.9	2.2	3.8	4.3
European Union (15)	48.1	42.6	48.1	53.6	55.3	60.4
Germany	7.5	8.9	10.0	12.7	11.9	18.8
France	6.3	6.2	8.4	7.5	9.1	8.8
Italy	9.5	8.5	6.7	10.2	9.2	7.5
United Kingdom	2.4	2.6	5.4	4.2	5.7	7.1
Netherlands	8.2	5.6	6.0	73.9	6.9	6.9
Austria	6.9	3.7	3.6	2.6	3.7	2.8
United States	36.3	32.7	24.6	24.7	22.5	18.0
International Companies [b]	10.2	18.7	16.1	12.4	9.3	6.6
Korea, Rep. Of Russia	0.2	0.1	1.0	1.5	6.1	5.2
Foreign direct investment inflows by activity (percent of total:	0.7	0.5	6.3	0.2	0.1	3.5
a, c	0.3	0.2	0.1	0.1	0.1	0.1
Agriculture	0.0	0.0	0.0	0.0	0.1	0.0
Mining and quarrying	52.9	53.7	58.1	58.2	62.4	58.3
Manufacturing, including	15.1	16.6	19.9	21.1	18.5	16.4
- food products, beverages and tobacco[d]	..	..	..	..	14.2	13.3
- transport equipment	7.7	3.0	6.5	5.1	6.5	5.0
- pulp, paper and paper products, publishing and printing[e]	7.9	5.9	7.8	5.3	6.1	4.8
- chemicals and chemical products[f]	7.2	6.2	5.2	4.0	0.5	0.9
Power, gas and water supply [h]	39.6	39.9	36.6	37.7	36.9	40.7
Service , including	13.3	8.8	7.3	5.0	3.1	6.2
- Construction	13.2	19.0	19.0	21.2	17.7	17.6
- Financial inter-mediation [h]	4.9	5.3	5.5	5.9	8.0	10.8
- Wholesale and retail trade, repairs[I]						

a Data only include foreign direct investment over USD 1 million. Data are not available prior to 1993

b Includes the European Bank for Reconstruction and Development (EBRD)

c Data wee reclassified in 1997 using the European Classification of Activities (NACE). Therefore, the data prior to 1996 are not fully comparable with data of 1997 and onwards.

d For data prior to 1997, classification group was named food processing.

e For data prior to 1997, classification group was named wood and paper.

f For data prior to 1997, classification group was named chemical.

g For data prior to 1997, classification group was named light, fuel and power.

h For data prior to 1997, classification group was named finance and insurance.

i For data prior to 1997, classification group was named trade.

Table 4.6
Exports by Destination 1980-98

	1990	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total (USD billion)	7.0	3.6	4.9	3.2	4.0	7.2	2.9	4.4	5.7	8.2
(Percent of total)										
America	.7	7	.2	.0	.7	.0	.4	.8	.9	.0
United States	.5	.8	.5	.3	.9	.4	.7	.3	.6	.7
Canada	.4	.4	.4	.3	.3	.3	.3	.3	.3	.3
Others	.9	.4	.3	.4	.2	.2	.4	.1	0	.0
Europe	5.2	5.4	8.5	5.4	4.0	4.0	9.8	0.0	0.8	2.0
EU15	4.4	4.8	4.1	5.6	8.3	8.3	0.1	6.6	4.3	8.0
Germany	5.5	5.1	9.3	1.4	5.6	5.6	8.4	4.5	3.0	6.3
Italy	.9	.9	.1	.5	.9	.9	.9	.5	.9	.9
Netherlands	.0	.1	.2	.0	.8	.6	.6	.8	.7	.8
France	.9	.2	.8	.6	.9	.6	.6	.4	.4	.7
United Kingdom	.2	.1	.1	.3	.5	.0	.0	.9	.8	.9
EFTA	.0	.7	.5	.7	.6	.6	.6	.2	.5	.7
East Europe	5.5	2.1	6.8	5.4	3.5	7.3	7.3	0.4	4.1	0.9
Former USSR	1.2	5.3	1.0	.3	.6	1.4	1.4	3.9	7.2	3.6
Russian Federation	.	.	.	.5	.3	.6	.6	.8	.4	.7
Ukraine	.	.	.	.4	.5	.2	.2	.0	.7	.9
Other Europe	.2	.8	.1	.7	.6	.8	.8	.9	.9	.0
Asia	.2	.3	.4	.7	.7	.4	.4	.8	.8	.7
Middle East	.3	.1	.0	.1	.7	.2	.2	.2	.9	.3
East Asia	.2	.4	.9	.0	.6	.6	.6	.2	.5	.2
South Asia	.6	.8	.4	.5	.4	.6	.6	.3	.3	.3
Africa	.8	.3	.0	.7	.7	.3	.3	.4	.43	.1
Other	.1	.4	.9	.2	.6	.1	.1	.1	.2	.3

Source: Trade Policy Review: Poland 2000, Geneva: 2000, World Trade Organization

Table 4.7
Poland's Trade by Main Partner Country in 1993 and 1999

	Exports				Imports				Balance	
	Value (US$ million)	Share (%)		Annual change (%)	Value (USD million)			Annual change (%)	Value (USD million)	
	1999	1993	1999	99/93	1999	1993	1999	99/93	1993	1999
World	27 407	100.0	100.0	11.7	45 911	100.0	100.0	16.0	-4 691	-18 504
EU-15	19 326	69.2	70.5	12.0	29 826	64.8	65.0	16.1	-2 409	-10 499
Germany	9 904	36.4	36.1	11.5	11 583	28.1	25.2	14.0	-146	-1 679
Italy	1 792	5.2	6.5	15.9	4 297	7.8	9.4	19.6	-728	-2 505
France	1 328	4.2	4.8	14.4	3 134	4.3	6.8	25.5	-209	-1 805
EFTA-4	561	1.9	2.0	13.2	1 145	3.6	2.5	9.0	-419	-585
CEFTA-6	2 237	5.4	8.2	19.6	3 071	4.3	6.7	25.1	-36	-834
Czech. Rep	1 041	2.4	3.8	20.4	1 472	1.9	3.2	27.0	-8	-431
Hungary	539	1.2	2.0	20.7	624	0.9	1.4	24.8	9	-86
Other CECs"*	857	1.0	3.1	34.7	318	0.9	0.7	11.5	-22	539
CIS	1 823	7.3	6.7	9.9	3 301	9.0	7.2	11.8	-657	-1 477
Russia	710	4.6	2.6	1.6	2 676	6.8	5.8	13.2	-627	-1 965
Ukraine	703	1.3	2.6	24.6	339	1.1	0.7	9.1	-13	365
United States	755	2.9	2.8	10.7	1 643	5.2	3.6	9.1	-564	-888
Chine	133	1.2	0.5	-3.5	1 219	1.2	2.7	31.8	-60	-1 086
Rep. Of Korea	54	0.3	0.2	4.9	1 179	0.9	2.6	33.3	-125	-1 125
Japan	43	0.3	0.2	-2.0	927	1.8	2.0	30.7	-281	-884
Other	618	10.4	5.9	1.6	3 284	8.5	7.2	12.8	-120	-1 666

*Albania, Estonia, Latvia, Lithuania, Bosnia-Herzegovina, Croatia, Serbia and Montenegro, Macedonia.

Source: Same as table 4.6

Poland: Main Trade-Related Legislation, 1999

Main trade legislation on exports and imports	The basic rules and regulations on foreign trade are laid down in the law on Economic Activity of 1988; the Customs Code of 1977; the Law on Administering Foreign Trade of Goods and Services and on Special Trade of 1997; and the Law on Principles of Special Control of Foreign Turnover in Goods and Technologies in Connection with International Agreements and Obligations of 1993; the Law on State Standardization and Supervision of Food and Agricultural products in Foreign Turnover of 19996.. The Customs Code provides the legal framework for the Polish tariff system, including rules on the imposition of anti-dumping and countervailing duties, import bans, export and import licensing, the establishment of export and import quotas and safeguard measures.
Anti-dumping and countervailing duties and safeguard measures	Law on Protection Against Importing Goods into the Polish Customs Territory at Dumped Prices of 1997; Law on Safeguards Against an Excessive Importation of Goods into the Polish Customs Territory of 1997.
Government procurement	Law on Public Procurement of 1994.
Competition	Law on Counteracting Monopolistic Practices of 1990; Law on Preventing Unfair Competition of 1993.
Standards	Law on Standardization of 1993.
Sanitary and phytosanitary measures	Law on Commercial Inspection of 1958; Law on Inspection of Purchase and Processing of Agricultural Products of 1970; Ordinance on the Protection of Topographies of Integrated Circuits of 1993; Law on the Inventive Activity of 1972; Law on Patent office of the Republic of Poland of 1962; Law on Patent Agents of 1993; Law on Patent Office of the Republic of Poland of 1962; Law on Patent Agents of 1993; Law on Trademarks of 1985.
Special economic zones	Law on Special Economic Zones of 1994.
State aid	Law on Corporate Income Tax of 1992; Law on Public Finance of 1997; Law on Financial Restructuring of Enterprises and Banks of 1993; Law on Restructuring of Cooperative Banks and Food Economy Bank 19994; Laws on on Sureties and Guarantees Granted by the State Treasury on 1997; Law on Export Contracts Insurance Guaranteed by the Treasury of 1994; Law Ordinance of 1997; Law on Export Contracts Insurance Guaranteed by the Treasury of 1994; Law on Establishment of Agency for Agriculture Restructuring and Modernization of 1993.
Privatization	Law on Economic Activity of 1988; Law on Commercialization and Privatization of State Enterprises of 1996; Law on State-owned Enterprises of 1981.
Price control	The Law on Prices of 1982.
Foreign investment	Law on principles of Conducting Economic Activity in a Small Industry by Foreign Legal and Natural Persons in the Territory of the Polish People's Republic' Law on Companies with Foreign Shareholdings of 1991.

Source: Same as table 4.6

Table 4.9
Poland's Preferential Trade Agreements 1999

Country	Date of signing agreement	Major Polish exports and imports covered by the agreement	Other major areas of cooperation (excluding WTO commitments)
European Union (EU)2	16 December 1991 (entry into force 1 February 1994)b	Imports : phased reduction of duties on industrial products; duty free by 1 January 1999 (except steel and petroleum products from 2000, and vehicles by 1 January 2000) Exports - duty free on industrial products by 1 January 1995; duty free on coal and steel by 1 January 1996;	Competition; intellectual, industrial and commercial property; movement of workers; procurement; standstill and services
European Free Trade Agreement (EFTA)c	10 December 1992 (provisionally 15 November 1993, entry into force 1 September 1994	Imports - phased reduction of duties on industrial products; duty free on industrial products by 1 November 1993 (except chemical products to Norway by the beginning of 1996, tariffs and quotas on textiles and clothing to Norway by the end of 1997, and tariffs on oil products to Iceland) Duty free on some fish, marine and processed agricultural products (bilateral arrangements covering some agricultural products).	
Central European Free Trade Agreement (CEFTA)	21 December 1992 (provisionally 1 March 1993, entry into force 1 July 1994	Phase reduction of duties on industrial products; duty free on industrial products since 1 January 1999 (except cars by 1 January 20002)d	Competition, intellectual property, monopolies, and procurement
Estonia	5 November 1998 (provisionally 1 January 1999)	Phased removal of duties on industrial products by 1 January 2002; duty free; tariff quotas on some agricultural products on exports to Poland (except fish exports - free from 1 January 2000); Polish exports of agricultural products duty free immediately.	Competition, intellectual property, monopolies, and procurement
Latvia	28 April 1997 (provisionally 1 April 1998, entry into force 1 June 1999)	Phase removal of tariffs on industrial products by 1 January 2001 (except cars by 1 January 20002); tariff concessions on certain agriculture products; for certain fish products duty free in mutual trade from 1 January 2000.	Competition, intellectual property, monopolies and procurement.
Lithuania	27 June 1996 (entry into force 1 January 1997)	Phase removal of duties on industrial products by 1 January 2001 (Except cars by 1 January 2001) Tariff rate quotas on some agricultural products	Competition, intellection property, monopolies and procurement.
Israel	1 July 1997 (provisionally 1 March 1998, entry into force 1 May 1999)	Phased reduction on industrial products; complete elimination by 1 January 2001 (except cars by 1 January 2002 tariff rate quotas on some agricultural products.	Competition, intellectual property, monopolies and procurement

Turkey	4 October 1999	Phased removal of duties on industrial goods by 1 January 2002; tariff concessions on some agricultural products	Competition, intellectual property, monopolies and procurement

a) A free-trade agreement with Finland, which became a member of the EU in 1995, has been in place since 1985.

b) The trade accord replaced a trade agreement from September 1989, the Trade and Economic Co-operation Agreement. The by the Community on imports of Polish origin.

c) Member countries are Iceland, Liechtenstein, Norway, and Switzerland.

d) Products excluded are products originally falling within Chapters 1-24 in the nomenclature preceding the Harmonized Description and Coding System (HS), but which were transferred at the time of the introduction of the Harmonized system into HS Chapters 25-97. However, the products may be covered by bilateral agricultural arrangements or by the provisions relating to processed agricultural products.

e) Member countries are the Czech Republic, Hungary and the Slovak Republic (in 1994 as the founding members), Slovenia (since 1 January 1996) and Romania (since 1997).

Source: Same as table 4.6

Table 4.10
Membership of International Agreements, Conventions and Treaties on Intellectual Property Protection, 1999

Title	Date of Poland's membership
Convention Establishing the World Intellectual Property organization (WIPO Convention of 1967)	March 1975
Paris Convention for the Protection of Industrial Property	
- Paris Convention 1883	November 1919
- Stockholm Act 1967.	March 1975
Patent Co-operation Treaty (PCT 1970)	December 1990
Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedures (Budapest Treaty 1977)	September 1993
International Convention for the Protection of New Variety of Plants (IPOV) Geneva Act 1978)	November 1989
- Madrid Agreement-Marks 1891)	March 1991
- Stockholm Act 1967	March 1991
Madrid Agreement for the Repression of False or Deceptive Indications of Source of Goods	
- Indications of Source 1891	January 1928
- The Hague Act 1925	December 1928
Bern Convention for the Protection of Literary and Artistic Works	
- Bern Convention 1886	January 1920
- Rome Act 1928	November 1935
- Paris Act 1971	Articles 22 to 38: August 1990; Articles 1 to 21:October 1994.,
Universal Copyright Convention	March 1977
- Geneva Act 1952	March 1977
- Paris Act 1971	
Rome convention for the protection, producers of phonograms and broadcasting organizations	1997
Protocol relating to Madrid agreement Concerning international registration of marks	March 1997

Nice agreement concerning international classification of goods and services for the purpose of registration of marks	March 1997
Vienna agreement establishing an international protection of figurative elements of marks	December 1997
Strasbourg agreement concerning the international patent classification Nairobi agreement on the protection of the Olympic symbol	November 1996

Source: Same as table 4.6

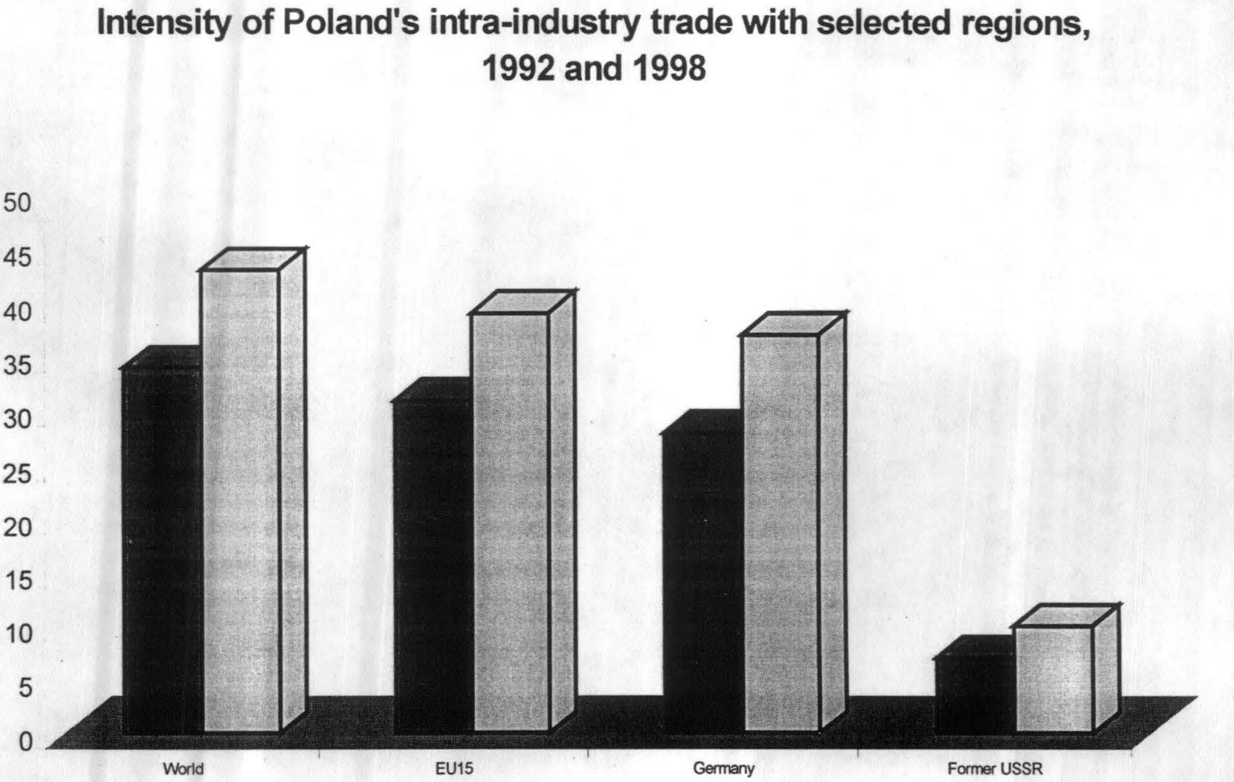
Table 4.11
Summary of Intellectual Property Protection in Poland, 1999

Form	Main legislation	Coverage	Duration	Sanctions
Patents	Law on the inventive Activity of 1972	Any invention that is a new solution of a technical character and capable of practical application	20 years from date of filing	Imprisonment for from 3 to 12 months and fine
Copyright and related rights	Law on Copyright and Neighboring rights of 1994	Any and all manifestations of creative activity of an individual nature established in any form irrespective of destination or manner of expression	Life of author plus 50 years	Imprisonment of up to 3 years and fine
Trade Marks	Law on Trademarks of 1985	Words, designs, ornaments, colors, three-dimensional forms, melodies, acoustic signals	10 years from the filing, renewable for periods of 10 years	Imprisonment of up to 1 years and fine
Industrial designs	Order of the Council of Ministers Covering the protection of Designs of 1963	Designs of forms, surface, lines or colors, etc of an industrial product, which conveys an aesthetic effect	5years,renewable for an additional 5 years	...
Layout designs of integrated circuits	Law on the protection of Topographies of integrated circuits of 1992, Ordinance on the protection of Topographies of integrated circuits of 1993	Any original solution consisting of three-dimensional arrangement of the elements(at least one active element) and of all or some interconnections in an integrated circuit	10 years from filing or from when first commercially exploited, whichever term expires earlier	Imprisonment of up to 1 years and fine

Source: same as table 4.6.

<u>Figure 4.1</u>

Poland's Intra-Industry Trade with Selected Regions 1992 and 1998



Source: wto.org/Pol/pr/23100/2000/htm.

Ten Years of Reforms: An Assessment

Gauging a nation's feat and fate is no easy task, especially if the country is Poland, which is a transition economy and a significant proponent of polemical lobbies in the new world order. Perhaps, that is why concluding outlook on its economic endeavor is a Herculean job. Nonetheless, the results have an interesting tale to tell.

Broadly speaking Poland has achieved its objective. One of the prime goal for Poland, when it embarked on its transformation plan was to transform into a full-fledged, functioning market economy. As Balcerowicz in his address to the Sejm, while presenting the Economic Transformation Program said:

"The goal is to make a rapid change into the economic system to a market system. Only thanks to this we can set in motion the process liberating human initiative and enabling us to make gradual improvement in the living conditions."[1]

A decade later, today Poland is being scrutinized in terms of economic performance and reform measures by a host of observers. The results are not discouraging at all.

Poland has been termed as fully functioning market economy by the European Union (EU).[2] It gained entry into the Organization for Economic Co-operation and Development (OECD) in 1996. Poland is a forerunner in the race for EU accession, which also speaks volumes on its performance. Considering the fact that there are almost a dozen aspirants for the EU membership, Poland seems to have done its homework well.

One of the recent reports by an international consultancy firm has the following to say regarding Poland's transformation:

"If deregulation, privatization, and openness to outside investment continue and the government steers clear of regulatory gaps - Poland will continue to show that economic "shock therapy" can create a flourishing economy[3]*."*

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[1] Summary of World Broadcast, 11 October 1989, EE/0584/B/5
[2] Poland's Accession to the European Union, http://www.europa.eu.int
[3] The Mckinsey Quarterly, 2000 Number 2, p. 88 http://www.mckinseyquarterly.com/article_page.asp

Poland's miraculous economic resurgence is one of the most significant economic developments of the global economy. The former satellite of the Soviet Union stands today as the only one to make the harrowing transition from stagnation of the previous system to the high-growth, high-risk, high-profit phase of the present one. It is widely believed that the country's success has been founded on tight fiscal discipline, together with capital and product market reforms, which ensured that all business compete on equal terms and capture the benefit of rising productivity.

The existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy[4].

The real GDP was up by almost 25 percent from the pre-transition levels and averaged at USD 4000, in 1999. An average growth rate of 5 percent has been registered for the last 10 years. This was also in face of the Russian economic crisis and the slowdown of the German economy, both of which happen to be significant external partners. Growth is expected to accelerate in 2001 and reach 5-6 percent, owing to the resumed double-digit export growth[5].

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[4] Copenhagen Criteria and EU Accession, http://www.europa.eu.int.

[5] *Trade Policy Review Poland 2000* : Geneva: 2000, World Trade Organization, p. 27

State fiscal deficit, which had fallen to 1.3 percent of the GDP in 1997-98, surged in to 3 percent in 1999. It is expected to stay at 2 percent for the current fiscal year. Inflation has fallen steadily over the last few years, owing to prudent stabilization measures. However it still hovers around a high figure of 7 percent and is expected to stay within 4 percent for 2000-2001. High interest rates were reduced from 24 percent in 1998 to 13 percent in 1999. They were raised again in 2000, in response to a quickening of the economy and high inflationary pressure[6].

In 1999 itself, the Polish economy expanded by 4.1 percent, somewhat slower than in previous year. However, there was a very significant acceleration of output in the second half of the year 5.6 percent, continuing into 2000. Industrial production was growing at a faster pace, by almost 10 percent in the period from January to May 2000, compared with 4.3 percent in 1999[7].

The recovery has been primarily fuelled by domestic demand. Private consumption expanded by 5 percent in real terms, while gross fixed capital formation increased by 6.9 percent. Since the end of last year, the external sector is also contributing to growth. Trade data shows that the volume of exports decreased by 5.1 percent in the first three-quarters of 1999, but grew by 3.5 percent in the fourth quarter and 9.2 percent in the first quarter of 2000. The very significant widening of the current account deficit constitutes the

[6] ibid p..5.
[7] Poland Accession to the EU, http://www.europa.eu.int.

most pressing challenge for Poland's economic policy. The current account deficit represented 7.5 percent of GDP in 1999, compared to over 4 percent in the previous year, and is estimated to have reached some 8 percent of GDP in the period from January to April 2000. The high level of unemployment represents another significant policy challenge. Unemployment increased steadily since August 1998 to some 15 percent in 1999 according to ILO methodology[8].

Progress in reducing inflation from moderate to lower levels is proving difficult for Poland. In the second half of the last year, prices increased sharply as a result of a combination of factors: higher food and fuel prices, the impact of a depreciation of the Polish currency, excise and tariff duty increases and strong growth of household credit linked to the economic recovery. Year-on-year inflation returned to double digits this year. Average inflation was 7.3 percent in 1999, and it appears likely that the consumer price index at the end of 2000 will be higher than the upper band of the Monetary Policy Council target of 6.8 percent.

In April 2000, Poland moved to a free float, an exchange rate strategy consistent with the implementation of inflation targeting. The float should help the economy to accommodate real exchange rate appreciation and capital inflows more easily, and allow for the abolition of the remaining controls on short-term capital movements[9].

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8. Ibid.
9. Economic Survey of Poland, http://www.oecd.org/eco/surv/esu-pol.htm

Poland's current account deficit has widened during the recent years, primarily due to the dominance of the import growth over exports. The deficit, which was at 8 percent of the GDP in 1999, is also seen as a reflection of imbalances between domestic savings and investments. External debt has fallen from 37 percent of the GDP in 1995 to 27 percent in 1999. [10].

The country's trade policies are directed at increased liberalization and Poland seeks to maintain an active profile on the multilateral, regional and bilateral initiatives front. The European Union has replaced the former COMECON, as its largest trading bloc partner. Poland is a founding member of the World Trade Organization (WTO) and grants Most-Favoured-Nation status to all WTO members.

The privatisation programme is being implemented strongly and successfully. It foresees that 70 percent of state-owned enterprises will be sold or wound down by the end of 2002. The private sector accounts for at least two thirds of GDP, for about 70 percent of total value added and for more than 70 percent of the total employment. There has been acceleration in the privatisation of large state-owned enterprises in a range of industrial sectors. Apart from the financial sector, completed large transactions concern the national airline LOT, the biggest oil company Polski koncern Naftowy (PKN) S.A., and a first set of power plants. Since 1991, the Agricultural Property

[10] Trade Policy Review, op.cit, p. 27

Agency has sold some 846,000 hectares of land, or 27 percent of the total, while another 67 percent is leased[11].

Prices have been largely liberalised, with the exception of prices of electricity and central heating, which are still subject to direct regulation. To some extent, the government also continues to influence prices in public transportation, pharmaceuticals and telecommunication services.

There are no significant legal or institutional barriers to the establishment of new firms in Poland. There was a net creation in 1999 of more than 10,000 registered firms or some 7 percent of the total number of such companies. The Law on Economic Activity, signed last December, provides a comprehensive framework for enterprise creation.

Property rights are clearly established and transferable. The entrepreneurial and investment climate is good even though a certain degree of bureaucracy and difficulties with the enforcement of court decisions constitute obstacles to business activity. Earnest efforts, supported across the political spectrum, have stated to be made to deal with the problem of corruption.

Poland continues to improve its functioning as an open market economy through prudent macroeconomic policies and implementation of various types of structural reforms. There also exists a broad consensus on policies geared towards entrenching the transition process and preparing for

[11] Poland's Accession to the EU, op.cit.

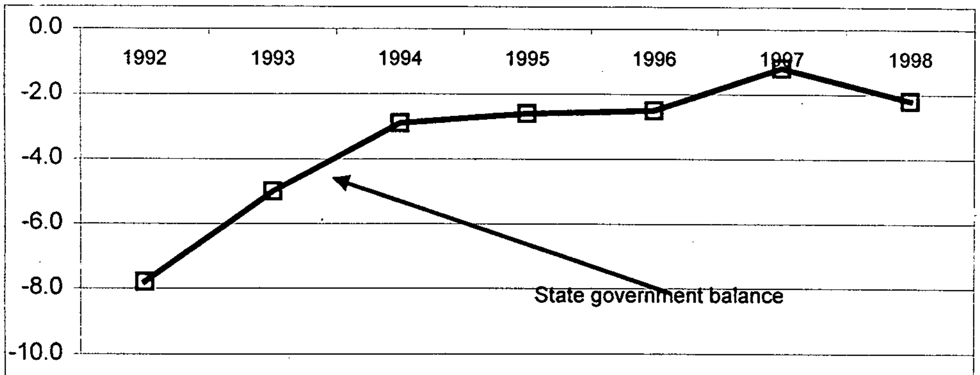
EU accession, especially around key issues such as privatisation, support for the development of the private sector and the need for foreign direct investment. The following tables show Polish experience with economic transformation in the last ten years.

Table 5.1
Main Economic and Social indicators

Area	312,685 km²	Urban share of population	62%
Population (1998)	38.7 million	Nominal GDP at current prices (1999, ZI billion) Per capita income (1998 current US$)	609.0 3,982
Annual population growth (1998)	1.8%	Sectoral share of GDP (percent, 1998) - Agriculture, hunting, forestry & fishing - Mining - Manufacturing - Services	3,982 4.2 2.5 19 74.3
Life expectancy at birth (1998) - Males - Female	 68.9 years 77.3 years	Sectoral share of formal employment (per cent,1998) Agriculture, hunting, forestry & fishing Mining Manufacturing Services	 25.8 3.2 28.8 42.2
Crude birth rate per '000 (1996)	10.2	Enrolment ratio in education (19970 - Primary - Secondary	 99.7 87.1
Infant mortality rate per '000 (1998)	9.5		

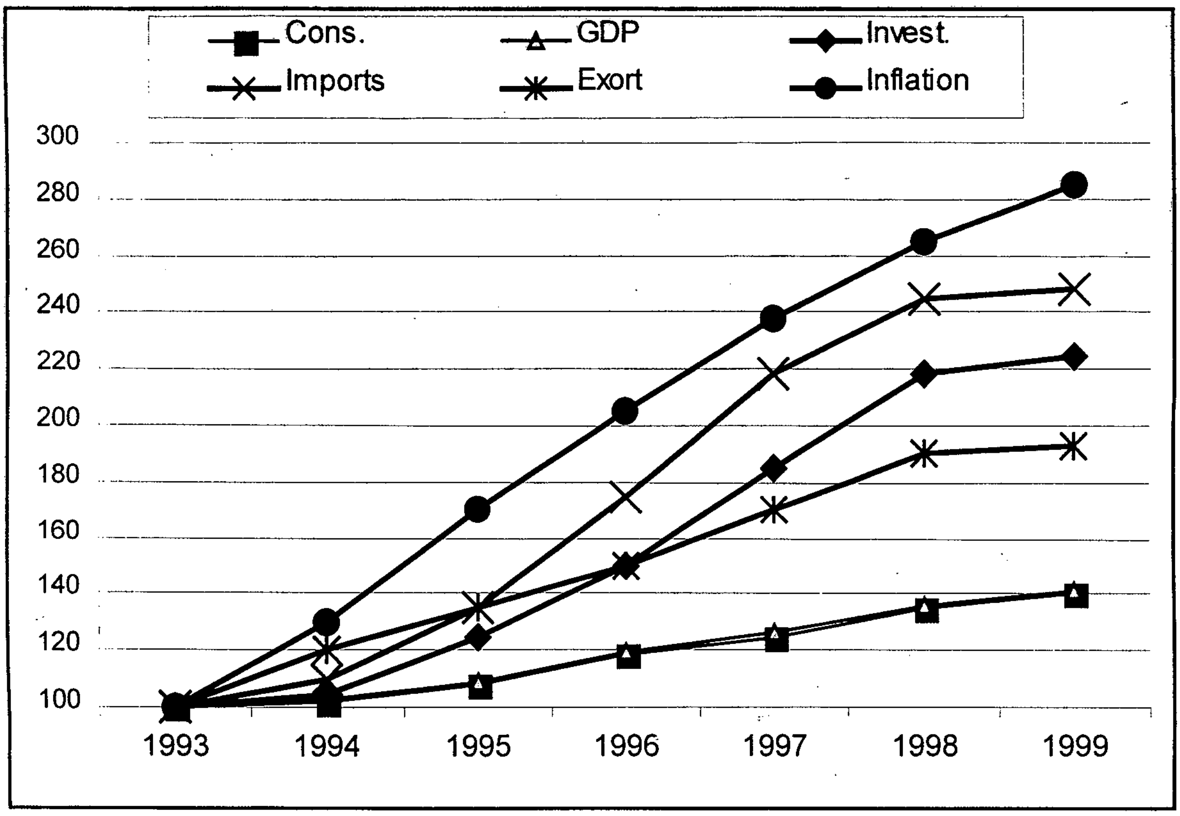
Source: European Union Delegation, New Delhi.

Figure 5.1
Fiscal Position 1992-98



Source : Central Statistical Office (various issues), Statistical yearbook of the Republic of Poland, Warsaw.

Figure 5.2
Volume Growth of Income Categories in Poland 1993-99



Source: same as table 5.1

Table 5.2
Economic Performance 1995-99

	1995	1996	1997	1998	1999[a]
National Accounts (constant Prices)	*(Percentage change)*				
Real GDP, market prices	7.0	6.0	6.8	4.8	4.1
Private consumption	3.6	8.7	7.1		..
Collective consumption	2.9	3.4	..		3.5
Gross fixed capital formation	16.9	20.6	20.6		10.6
Exports, goods and services	23.6	12.5	11.0		0.5
Imports, goods and services	24.3	28.0	21.4		6.0
Prices and interest rates	*(Percent)*				
Consumer price inflation (period average)	27.8	19.9	15.9	11.8	7.3
Bank lending rate (annual average)	33.5	26.1	25.0	24.5	17.5
Real effective exchange rate [b]	100.0	108.8	111.4	117.7	..
Savings and investment	*(Percent of GDP)*				
Gross investment	18.7	20.9	23.6	25.3	27.0
Private consumption	61.2	63.1	63.5	62.3	62.5
Public finance					
State government balance[c]	-2.6	-25	-1.3	-2.4	-2.2
Revenues from customs duties	2.0	1.8	1.6	1.1	0.8
Consolidated central government balance[d]	-1.3	-2.3	-1.8	-2.7	..
Total outstanding public debt	55.7	49.4	46.2	42.7	38.9
Monetary Sector (end period)					
M1	34.7	13.1	18.2	13.0	..
M2[e]	34.9	31.1	29.1	25.2	15.3
External Sector	*(Per cent of GDP, unless otherwise specified)*				
Trade balance	2.3	-2.4	-4.3	-5.4	-6.7
Current account balance	-2.0	-1.4	-4.1	-5.8	-7.5
Capital and Financial account balance	2.3	3.6	5.6	7.0	6.1
Foreign direct investment, net	1.0	2.0	1.2	3.9	4.5
Portfolio investment, net	1.0	0.2	1.5	0.4	1.6
Total external debt (end-period)	37.2	32.3	29.4	27.3	27.2
Short-term external debt (STED)	1.8	2.0	2.8	..	..
Debt-service ratio, paid[f]	12.2	7.8	5.8	6.9	7.0
Gross official reserves, US$ billion[g]	15.0	18.0	20.7	27.4	27.3
Reserve cover (Months of GS imports)[g]	6.5	5.8	5.9	6.8	8.0
Merchandise trade (imports plus exports)	40.0	42.4	48.5	46.7	43.9
	(Twelve-month growth rate, end period, per cent)				
Merchandise export growth[h]	35.0	6.7	11.5	10.6	-12.4
Merchandise import growth[h]	38.9	31.9	18.2	13.8	-6.8
Memorandum item:					
Nominal GDP (US$ billion)	119.1	134.6	135.6	158.4	154.1

.. *Not available.*
a Preliminary.
b Increase equals zloty appreciation.
c Since 1998, income from privatization does not constitute current income to the state budget but is source of financing the budge deficit.
d Includes state budget, Social Insurance Fund, Pension Fund and Labour Fun.
e M2= M1 + interest bearing local-currency deposits and other deposits + treasury bills.
f Debt service as a share of exports of goods and non-factor services in convertible currencies.
g GS=goods and services. Total reserves, including gold.
h Current U.S. dollars

Source: Data supplied by the Polish authorities; Central Statistics Office (various issues), Quarterly Statistics, Warsaw; Central Statistical Office (1998), Statistical yearbook of the Republic of Poland, Warsaw; and IMF (various issues), International Financial Statistics.

Table 5.3
Major Economic Indicators in 1999

Gross Domestic Product growth	4/1%
Gross outlays on fixed capital growth	6.9%
Industrial output growth	4.3%
Productivity growth	9%
Construction growth	3%
Unemployment rate	13%
Inflation rate	7.3%
Rediscount rate (December)	19%
Budget deficit	2.0% of GDP
Foreign debt	39%GDP
Public debt	43% of GDP
Foreign trade: Export revenue Import expenditures Trade deficit	 USD 26.3 bn USD 40. 7 bn USD 14.4 bn
Liquidity –import coverage	7 months
Foreign debt/ export ratio	2.3
Foreign reserves (December)	USD 25. 5 bn
Foreign direct investments	USD 8.3 bn
Average exchange rate	3.975 PLZ/USD 2.1612 PLZ/DEM
Wages (average gross monthly)	PLZ 1,707
Minimum gross salary	PLZ 700

Source : Embassy of Republic of Poland, New Delhi.

The Polish cabinet has adopted a strategy for public finances and economic development to the year 2010, on 22nd June 1999. The strategy was aimed at faster job creation. The country required 3-4 million new jobs to diffuse hidden unemployment and the demographic boom entering working age. [12]

The then Finance Minister, Leszek Balcerowicz said that the strategy called for balancing the state finances by 2003-4. He also added:

"We assume that inflation should go markedly down below 4 percent per annum in the coming years. The rate of economic growth should pick up already next year, reaching 5.1 percent."

The government seeks to eliminate deficit financing by 2003. The slight surplus is expected to be used for paying off public debt. After 2009, the public debt/GDP ratio would fall below 20 percent, according to the plan. [13]

Poland has come to establish itself as a successful transition economy, although there is much more that needs to be accomplished. Attempts to stabilize the economy, work on public finances, monetary reforms, creation of market structures, legal framework and pursuance of trade initiatives is paying off.

The main challenge before Poland is to maintain prudence in its monetary-fiscal policies, target inflation as a key issue, further consolidate public finance, protect market mechanisms, adjust to external shocks and improve functioning of the capital market. Rigidities in the labour market also need to be worked upon. Creation of healthy competition and enterprise another milestone to reach for Poland, in order to ensure sustained growth.

All these measures and perspectives will guarantee that Poland fulfils its ambitious plans to join the EU and keep the promises made to its people in bringing them a better quality of life coupled with the spirit of democracy and enterprise.

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[12] Summary of World Broadcast, PAP News Agency, Warsaw, 24 June 1999 EE/3569C/4.
[13] Ibid. EE/3569C/4

Table: 5.4

Poland : Main Economic Indicators (1980-2000)

POLAND (Indices 1989=100 or earliest availsble thereafter)	1980	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Real GDP/NMP	91.1	95.9	99.8	100.0	88.4	82.2	84.4	87.6	92.1	98.6	104.5	11.7	117.1	121.8	126.8
Real Total Consumption Expenditure	108.0	111.8	147.7	100.0	88.3	94.9	98.2	103.0	107.0	110.5	118.4	125.6	130.8	136.8	139.6
Real Gross Industrial Output	86.3	95.5	100.5	100.0	75.8	69.7	71.7	76.3	85.5	93.8	101.6	113.3	117.3	122.9	131.6
Total Employment	102.0	100.8	100.1	100.0	95.8	90.1	86.3	84.3	85.1	86.7	85.7	88.3	90.8	92.9	90.4
Employment in Industry	--	--	--	100.0	93.7	86.1	76.7	74.4	73.8	76.2	75.6	75.8	75.0	69.5	-
Registered Unemployment (% of labor force, end of period)	--	--	--	6.5	12.2	14.3	16.4	16.0	14.9	13.2	10.3	10.4	13.1	15.0	-
Consumer Prices (annual average, % changeover preceding year)	--	--	--	585.8	70.3	45.3	36.9	33.2	28.1	19.8	15.1	11.7	7.4	10.1	-
Producer Indices (annual average, % changeover preceding year)	--	--	--	622.4	40.9	34.5	31.9	25.3	25.4	12.4	12.2	7.3	5.7	-	-
Nominal Gross Wages (annual average, % changeover preceding year, calculated from reported annual average wages)	--	--	--	365.5	64.0	41.2	37.8	39.8	30.1	25.8	19.9	14.1	10.2	-	-

Merchandise Exports (billion dollars	13.071	14.573	14.665	18.291	14.912	13.187	14.202	17.240	22.887	24.440	25.756	28.229	27.404	31.651	-
Merchandise Imports (billion dollars)	14.705	12.987	12.941	12.619	15.531	16.141	18.758	21.566	29.043	37.137	42.314	47.054	45.901	48.940	-
Balance of Trade	-1.634	1.586	1.724	5.672	-0.619	-2.955	-4.555	-4.326	-6.156	- 12.697	- 16.558	- 18.825	-18.497	- 17.289	-
Exchange Rates (annual average, national currency units per dollar)	Zloty[14]	3.05	430.64	1439	9500	10576	13627	18136	22723	2.42	2.70	3.28	3.49	3.96	4.35
Current Account Balances (million dollars)	716	-1359	-269	-2869	677	5310	-1371	-4312	-6858	-11569	-9978	-	-	-	-
Inflows of Foreign Direct Investment (million dollars; cash basis)	10	117	284	580	542	1132	2768	3077	5129	6471	9461	-	-	-	-

Source: http://www/imf.org.

[14] Zloty was redominated at 1.10,000 from 1 January 1990. Convertible currency until 1992.

APPENDIX

AGENDA 2000, ENLARGMENT

Bulletin of the European Union, Supplement 6/98

Regular Report from the Commission on Poland's Progress Towards Accession

CRITERIA FOR MEMBERSHIP

1. Political criteria

Introduction

In its 1997 opinion of Poland's application for EU membership, the Commission concluded that:

'Poland present the characteristic of a democracy, with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities.'

The accession partnership sets out the requirement to pay further attention to ensuring equal access to public services as a medium term priority.

Recent Developments

The elections of September 1997 brought to power a new coalition government comprising Solidarity Electoral Action (AWS) and the Freedom Union (UW). Poland's political institutions continue to function properly in conditions of stability, including as regard cohabitation between the executive and the president. This stability has been consolidated with the entry into force of the new constitution on 17 October 1997. EU membership remains a top political priority for the government.

1.1. Democracy and the Rule of Law

The Parliament

The Parliamentary process is bases on stable institutions and continues to function satisfactorily.

The Executive

The executive continues to function instable conditions and the principal reforms and developments are outlined below.

State Administration Reform

A fundamental reform of the state administration at central. Regional and local levels have been decided and will enter into force on 1 January 1999. The reforms will replace existing structures by devolving powers to three levels of self- government at regional (voivodships), country (Poviats) and commune (Gminas) levels and by reducing the number of Voivodships from 49 to 16 provinces in the future. Regional self- government will be provided in the new 16 voivodship through regional governors (voivods) appointed by central government, and new elected regional councils (Sejmiks). The Sejmiks will be responsible for the development and implementation of region economic policies and will have independent legal identities and budgets. At country level, 308 Poviats plus 65 city Poviats will be created with an elected Poviat Representation (average 100 000 inhabitants), fixed assets and their own revenues and primary responsibility for the provision of public services. At commune level, the 2489 Gminas will be given new budgetary resources and new tax-raising powers to undertake the provision of primary community services. The new system includes an 'equalization principle' principle' that will allow a redistribution principle' that will allow a redistribution of revenues between regions. Election to the new bodies took place on 11 October 1998.

Status of Service

A significant reform of the status of civil servants is required to reinforce the efficiency of the administration and to ensure the development of an adequate pre-accession administrative capacity. The implementation of the 1996 legislation has not achieved the desired results. A relatively small number of civil servant appointment has been made since its introduction and a large number of State officials remain with a different status.

A revised law aimed at improving the current situation is under discussion. The draft 1998 civil service act aims to establish an open, competitive career system to replace the 1982 law on State employees and the 1996 law on civil service issues. This would provide a new two tier corps of civil service employee with provision for competitive examinations for permanent status. A core concern in the implementation of the new act will be equal provision of access to the public service on an open and independent basis to ensure continuity of administration in the years ahead. The issue of remuneration in the years ahead. The issue of remuneration of civil servants is also address in the 1998 act and will require further attention in the years ahead to ensure the recruitment and retention of a body of experienced officials.

The Judiciary

The difficulties and constraints identified in the Commission's opinion remain a source of concern. The average time for processing court cases has progressively increased. Delays of up to four years in reaching first instance judgments in civil matters are not uncommon. In criminal processed cases are frequently not processed for a similar period of years whilst the maximum duration of preventive detention before trial is two years. The treatment of cases relating to real estate issues is severely hampered by the poor state of the land register. The enforcement of court rulings and access to the courts have not improved since the opinion.

However, the provision of the 1997 constitution set out a framework for significant reinforcement of the rule of law. Important developments during the last year include the following.

- The 1997 constitution has enhanced the functioning of the rule of law in particular regarding the powers of the constitution tribunal to resolve issues of conflict between different branches of the State authority and by providing citizens with judicial recourse in cases relating to the infringement of their constitutional freedom. The constitutional tribunal has exercised its function in accordance with its invested powers.

- The principle of the independence of the judiciary has been clarified in the context of the illustration process with the result that judges or prosecutors deemed to have worked with the secret service prior to 1989 may be barred from office if the process of law arrives at that conclusion.

- A new criminal procedures code, providing for improved operation of the criminal justice system in line with the European Convention on Human rights (ECHR) provisions, entered into force on 1 September 1998. The new code includes a greater emphasis on defense rights and respect for human dignity, reduces maximum detention time from 72 to 48 hours, and provides alternative punishments to incarceration.

- A new penal code and code of penal procedures adapted to conform to European Convention of Human rights standards entered into force of 1 September 1998. The new code replaces capital punishment with life or 25-years imprisonment. A number of other significant changes are made which serve to reduce the age limit for prosecution of minors on serious offences (to 15), to reduce the minimum period for detention (to one month), to reduce the maximum punishment threshold for certain serious offences and to increase penalties for serious crimes. The code also introduces new categories of criminal offences (e.g. computer and environmental crime). The penal code reform is timely and conforms to the principles of *nulla poena sine lege*, *lex retro non agit*, and *nullum crimen sine lege*, but continues to be subject to a lively political debate.

Further efforts are required to improve the status of judges, prosecutors and officials. In particular, the level of enforcement of judicial decisions and the length of judicial proceedings, particularly in commercial matters, require significant further efforts.

Anti-Corruption Measures

The opinion highlights the need to intensity the fight against corruption. However, the efforts undertaken by the Polish authorities since the opinion have not responded adequately in relation to the importance of the issue and little progress has been made on the establishment of a genuine anti-corruption policy. The 1990 European Convention on laundering, Search, Seizure and Confiscation of proceeds from crime is not yet ratified. Poland signed the OECD Convention on Corruption in December 1997.

1.2 Human Rights and Protection of Minorities

It would appear that there have been no cases of inhuman and degrading treatment recorded in Poland since the opinion. Poland has already acceded to most of the major human rights instruments. The 1997 constitution provides explicit protection for the citizen's right to privacy.

Protocols 6 and 7 of the ECHR, and the Framework convention for the Protection of National Minorities have not yet been ratified. However, Poland has ratified Protocol 11 of the ECHR and the European social Character during the last year.

Civil and Political Rights

Basic rights continue to be respected and some developments were registered in the last year, in particular the following.

The office of Commissioner for civil Rights Protection (CCRP) has been established. With a staff of 190, the CCRP office is functioning well and has made a significant contribution to the protection of citizens' rights. The CCRP is appointed by the Sejm for a five-year tenure, his decisions are not subject to appeal, citizens are entitled to free access and the commissioner enjoys high public confidence. The CCRP has reported that further efforts are required to improve provisions for legal resource for members of certain professional groups (armed forces, civil servants, medical profession) who have been subject disciplinary measures.

The 1998 data protection law sets out the improved provision in this area and has led to the establishment of a general inspector for data protection.

The commission for Civil Rights Protection has prepared an assessment of the procedures and practices on wiretapping and control of private correspondence and a review of the law on access to information is under consideration regarding the provision for 'disclosures of financial information to the State authorities.

- An important debate bas developed regarding the 1997 'lustration' or vetting act which required that those holding or seeking elected posts and senior government judicial, or public media positions would submit declaration as to whether they were agent for the security police from 1944 to 1990. An admission of involvement would not automatically debar the individual from office. The vetting act provides for a vetting court which has not been established due to the absence of sufficient judges of the 21- person body and the act is therefore not enforced. Should Poland decide to adopt this legislation efforts will be required to ensure that the law is implemented in accordance with full respect for human rights and the due process of law.

As far as freedom of expression is concerned, Poland continues to have a lively and active press. The provisions of the penal code regarding the liability of journalists to prosecution due to 'slander and abuse' of the public authorities does not, in practice, appear to have caused problems for journalists' right to freedom of speech.

Poland's non-governmental organizations continue to play an important and influential role in national debate.

Given the significant increase in asylum applications between 1994 (598) and 1997 (3531) the treatment of asylum seekers remains and important issue. In general, asylum procedures are carried out in accordance with the law but further efforts are required to improve the speed of processing. A Refugee Council has been established under the 1997 aliens' act to treat asylum appeals.

Economic, Social and Cultural Rights

Basic social economic and cultural rights continue to be guaranteed. Nevertheless, human rights organizations have expressed their concerns about the need to make progress on national policies improving the treatment of women.

Minority Rights and Protection of Minorities

The respect for and protection of minorities continue to be assured and in particular.

- The 1997 constitution's explicit protection for minorities appears to be functioning well.

- Policy towards the *Germanophone* minority continues to be constructive with continuing special rights to electoral representation resulting in two members of the Sejm being elected. The proposed territorial reform will further the inclusion of the *Germanophone* minority through the creation of the region of Opole.

The president and Government of Poland have worked constructively to meet the concerns of the Jewish community. In particular, the Polish Government has made commitments to contribute to an international assistance fund for victim of Nazi oppression. It has to be recalled that the 1998 penal code provides for penalties against those who use the mass media to 'advocate discord' on national, ethnic, racial or religious grounds.

1.3 General Evaluation

Developments in Poland confirm the conclusion of the opinion that Poland fulfils the Copenhagen political criteria and its institutions continue to function smoothly. Important progress has been made in dealing with the weaknesses identified in the opinion, in particular as concerns civil rights protection and legislative measures regarding penal and criminal proceedings.

2. Economic criteria

2.1. Introduction

In its 1997 Opinion on Poland's application for EU membership, the Commission concluded:

"Poland can be regarded as a functioning market economy; it should be well able to cope with competitive pressure and market forces the Union in the medium term."

This finding was confirmed in both the 1998 and 1999 Regular reports. The General Evaluation of the Economic Criteria of the 1999 Regular report concluded:

"Poland is a functioning market economy, with increasingly thriving private sector and an appropriate legal and institutional environment for economic activity. It should be able to cope with competitive pressure and market forces within the Union in the medium term, provided it keeps up the pace of economic restructuring and proceeds with trade liberalization."

In its annual assessment of the economic developments in Poland since the 1997 Opinion, the Commission's approach is guided by the conclusions of the European

Council in Copenhagen in June 1993 which stated that membership of the Union requires:

- the existence of a functioning market economy;
- The capacity to cope with competitive pressures and market forces within the Union.

In the analysis below, the Commission has followed the methodology applied in the Opinion, as well as in the 1998 and 1999 regular reports.

2.2. Economic developments

The macroeconomic situation in Poland has improved since the Regular Report. The slowdown in growth, induced primarily by the Russian crisis in 1998, has been reversed since the middle of last year, and the economy is currently experiencing a strong recovery in output, linked to a pick-up in external demand and an acceleration of domestic demand. However, a number of macroeconomic imbalances have developed. The rate of unemployment is high and rising, and inflation picked up significantly in the second half of 1999. Higher growth is not offsetting employment losses associated with economic transformation. Moreover, the current account deficit has widened considerably. Although exports have picked up and FDI inflows remain high, import growth is even more robust, reflecting the rapid increase in domestic demand. In 1999, the public sector deficit was around 3.5% of GDP, with some fiscal loosening during the year, partly due to the difficult implementation of social sector reforms.

Poland continues to register progress in privatization and structural reforms. The pace of privatization has been particularly encouraging, with some 150 enterprises sold through direct privatization in 1999 and already 50 in the period to the end of April of this year, across a wide range of sectors. Revenues from privatization are exceeding the assumptions of the budget law, and are boosted further by the completion of the sale of a second trance of shares in Telekomunikacja Polska. Privatization revenues are primarily financing social sector reforms, but uncertainties remain as to the future of the enfranchisement programme, which foresees the distribution of shares to the population. There has also been some further restructuring of state-owned enterprises, in particular the coal mining and defense industries. There are, however, delays in privatization in the steel sector and in the restructuring of agriculture. State-owned enterprises continue to be a burden on overall efficiency and profitability and negatively affect public finances through tax and social contribution arrears. On the other hand, the implementation of pension, health care, education and tax reforms, albeit sometimes difficult and costly in the short-term are strengthening the basis for future growth.

2.3. Assessment in terms of the Copenhagen criteria

The existence of a functioning market economy

The existence of a functioning market economy requires that prices, as well as trade, are liberalized and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

Poland continues to improve its functioning as an open market economy through prudent macroeconomic policies and implementation of various types of structural reforms. Poland concluded a Joint Assessment of Medium Term Economic Policy Priorities with the European Commission services in February 2000. The Joint

Assessment, which covers the period to 2002, takes into account recently approved sector strategies and the longer term strategy for public finances that had been adopted by the previous Government in June 1999. There is broad political consensus on policies geared towards entrenching the transition process and preparing for EU accession, especially around key issues such as privatization, support for the development of the private sector and the need for foreign direct investment.

There are, nevertheless, divergences as to the speed at which reforms should be conducted. Pressures for trade protection are exerted in various sectors and the appropriate stance on public finances is heavily debated. The government has delayed decisions on the final liberalization of capital inflows under Poland's OECD commitments.

In 1999, the Polish economy expanded by 4.1%, somewhat slower than in previous year. However, there was a very significant acceleration of output in the second half of the year (5.6%), continuing into 2000, with GDP growth estimated at some 6% in the first quarter. Industrial production is growing at a faster pace, by almost 10% in the period from January to May 2000, compared with 4.3% in 1999. The recovery has been primarily fuelled by domestic demand. Private consumption expanded by 5% in real terms, while gross fixed capital formation increased by 6.9%. Since the end of last year, the external sector is also contributing to growth. Trade data shows that the volume of exports decreased by 5.1% in the first three-quarters of 1999, but grew by 3.5% in the fourth quarter and 9.2% in the first quarter of 2000. The very significant widening of the current account deficit constitutes the most pressing challenge for Poland's economic policy. The current account deficit represented 7.5% of GDP in 1999, compared to over 4% in the previous year, and is estimated to have reached some 8% of GDP in the period from January to April 2000. The sharp improvement in the central bank data recorded in April may suggest that an adjustment is taking place. The increase in the trade deficit (to 9.5% of GDP) in 1999 took place in the context of unfavorable external shocks in the past years. In addition to the deterioration of the trade balance, the widening of the current account deficit is due to a sharp decline in the surplus on unclassified transactions (unregistered border trade), which was halved in 1999 compared to the previous year, and a trebling of the deficit in services. The overall deficit is only partially financed by non-debt creating inflows.

The high level of unemployment represents another significant policy challenge. Unemployment increased steadily since August 1998 to some 15% in 1999 according to ILO methodology. Whilst the rise in unemployment reflects restructuring and demographic pressures, a number of specific features point at the need to improve the functioning of labor markets: the unemployment rate of persons under the age of 25 is around 30%, unemployment is high for low skilled workers, there are significant regional disparities (unemployment rate between 9% and 20%), and nominal wages in some sectors do not appear very responsive to the recent increases in the level of unemployment.

Progress in reducing inflation from moderate to lower levels is proving difficult. In the second half of the last year, prices increased sharply as a result of a combination of factors: higher food and fuel prices, the impact of a depreciation of the Polish currently, excise and tariff duty increases and strong growth of household credit linked to the economic recovery. Year-on-year inflation returned to double digits this year. Average inflation was 7.3% in 1999, and it appears likely that the consumer price index at the end of 2000 will be higher than the upper band of the Monetary

Policy Council target of 6.8%. The prospect of missing this target for the second year in a row highlights the difficulties of implementing an inflation-targeting framework for monetary policy in Poland. In April 2000, Poland moved to a free float, an exchange rate strategy consistent with the implementation of inflation targeting. The float should help the economy to accommodate real exchange rate appreciation and capital inflows more easily, and allow for the abolition of the remaining controls on short-term capital movements.

Since monetary policy is already tight, the combination of widening current account deficit and persistent inflation put the onus on fiscal policy as the only robust instrument for addressing imbalances. In 1999, the public sector deficit was estimated at some 3.5% of GDP, with a loosening of the fiscal stance in the course of the year for both cyclical and structural reasons. In the first half of the year, tax receipts have been lower than expected. The financial situation of the social security office ZUS has been of particular concern. The deficit of some of the state-owned enterprises, for example PKP (railways) is worrisome, and there has been a build up of tax and social security arrears. Despite these difficulties, the target level of 2.8% of GDP for the general government deficit in 2000 appears to be attainable. Pressures on government expenditure will be increasing in 2001 in view of the need to compensate for past inflation and offset higher debt servicing costs. Beyond windfall revenues (notably from the expected sale of UMTS telecom licenses) next year, effective fiscal consolidation of current expenditures is the key to restoring external balance in the medium term.

Regarding public expenditure management, the main structural weaknesses are the relatively high number of extra-budgetary funds and the need to embed their financial management within the procedures used for state budget expenditure. In this respect, it is worth noticing that the implementation of territorial reform has not been translated into a greater degree of fiscal federalism. According to the 2000 budget, both revenues (16%) and spending (17.1%) in the local government sector are due to increase, but tax income should remain flat. This implies that local budgets will increasingly rely on a subsidy from the state budget (rising 21.6% in nominal terms this year).

Significant progress has been made in the area of tax reform. The government completed last autumn the parliamentary process for the adoption of a sound and ambitious tax package, consisting of the broadening of the tax base, the lowering of tax rates, the simplification of the code and a reduction in tax breaks. This process, however, led to significant tensions within the previous coalition. Whilst the proposed changes in Corporate Income Tax and VAT were adopted, the government's Personal Income Tax bill was vetoed by the President and will not be re-introduced in the 2001 budget proposal.

The privatization programme is being implemented forcefully and successfully. It foresees that 70% of state-owned enterprises will be sold or wound down by the end of 2002. The private sector accounts for at least two thirds of GDP, for about 70% of total value added and for more than 70% of the total employment. There has been acceleration in the privatization of large state-owned enterprises in a range of industrial sectors. Apart from the financial sector, completed large transactions concern the national airline LOT, the biggest oil company Polski koncern Naftowy (PKN) S.A., and a first set of power plants. The major deal to be closed this year is the second trance (35%) of shares in the telecom operator TP S.A., and privatization in the gas, chemicals, distilleries, sugar and energy distribution sectors are in preparation. Overtime, since 1991, the Agricultural Property Agency has sold some 846,000 hectares of land, or 27% of the total, while another 67% is leased.

Prices have been largely liberalized, with the exception of prices of electricity and central heating, which are still subject to direct regulation. To some extent, the government also continues to influence prices in public transportation, pharmaceuticals and telecommunication services. According to the Polish authorities, administered and regulated prices represent about 2% of the consumer price index basket. The remaining liberalization of prices is directly linked to progress in the privatization of the energy sector, now underway. Trade is also largely liberalized. The major exception to price and trade liberalization remains the agricultural sector.

There are no significant legal or institutional barriers to the establishment of new firms in Poland. There was a net creation in 1999 of more than 10,000 registered firms or some 7% of the total number of such companies. The law on economic activity, signed last December, provides a comprehensive framework for enterprise creation; it expands the scope of entrepreneurship by giving a definition of a small and medium size enterprise, allows equal status to domestic and foreign firms and curbs state intervention in the economy by bringing down the number of sectors in which a license in required to conduct economic operations.

Barriers still remain to the exit of firms, especially in the case of bankruptcies. In this area, the judicial system is under strain to ensure an adequate processing of bankruptcy procedures. Amendments to the bankruptcy law are needed to change the balance of protection in favor of creditors, and to add other features, such as a central register for bank collateral and a central register of debtors to the State Treasury.

Aside from exist through bankruptcy, a new commercial code I in preparation for possible adoption around the end of this year. The code should facilitate transactions such as mergers and their spin-offs.

Property rights are clearly established and transferable. The entrepreneurial and investment climate is good even though a certain degree of bureaucracy and difficulties with the enforcement of court decisions constitute obstacles to business activity. Serious efforts, supported across the political spectrum, are starting to be made to deal with the problem of corruption.

The financial sector is developing, albeit from a low base. Indicators of financial deepening are steadily increasing. Financial intermediation is rising and domestic credit amounted to 28.8% of GDP, from around 20% in the middle of the decade. Commercial bank assets represented some 62.3% of GDP in 1999.

The banking sector has remained fundamentally sound since the middle of the 1990s. The "bad loans" problem of the early 1990s was largely overcome through the establishment of efficient regulatory and supervisory frameworks and institutions, some recapitalisation of banks, and a decentralized approach putting the burden of work-outs onto banks themselves, helped by new procedures such as bank-led conciliation and debt-to-equity swaps. These gave banks power over corporate clients and incentives to avoid the emergence of new non-performing assets. Bad loans, however, have grown again recently in the portfolio of banks since the Russian crisis as a result of corporate failures. By the end of last year, 13.4% of commercial banks' outstanding claims on the non-financial sector were reported as irregular. This reflects poor assessments of corporate credit risk in the past, as well as methodological changes to the reporting of problem loans.

The advanced stage of privatization in the banking sector is one of the key features of the Polish economy, and one of the its major strengths. In 1999, private owners controlled 70 out of 77 commercial banks and 39 are in the hands of foreign investors. Foreign investors. Foreign ownership now accounts for 56% of the total capital of Polish banks, and when all types of property links are considered, it is estimated that foreign investors control over 70% of commercial banks' total assets. In 1999 two banks were privatized (Bank Pekao S.A. and Bank Zachodni S.A.) and in April 2000 the first step for the privatization of the former state savings bank PKO BP was completed with its transformation into a Treasury corporation.

The present state of financial sector provides a good basis for future developments. Real interest rates are high, but the debt-servicing capacity of domestic borrowed extensively, including in foreign currency, and there is no evidence that this financing is hedged. It remains to be seen whether the move to a fully floating currency will influence the behavior of operators in this respect. Corporate indebtedness, however, is mostly medium and long term and an estimated 32% of liabilities at the end o last year was inter-company loans. Reserve indicators also remain comfortable, with gross official reserves representing more than 7 months of imports of goods and services at the end of June 2000.

Important market-oriented changes have taken place in the non-bank financial sector. Privatization in the insurance sector moved forward last year with the sale of a 30% stake in PZU S.A. in November. The sector has been boosted by the reform of the pension system, even though the issue of transferring from the first to the second pillar is unresolved. The insurance market nevertheless experienced two bankruptcies in 1999. Pension reform led to a 71% increase in the market capitalization of the

Warsaw Stock Exchange last year; it now represents around 20% of GDP (13.3% in 1998). Some regulatory changes in the non-bank sector are still needed, and some legal obstacles to effective supervision remain, notably in regard to consolidated supervision.

Poland is a functioning market economy. It has maintained an adequate degree of domestic and external macroeconomic stability, and its growth performance has again been impressive. However, a number of economic imbalances have emerged, and require adequate monitoring and policy measures. Inflation will be above the upper band of the Monetary Policy Council's target for the second year in a row. The current-account deficit has widened to a level that raises issues of sustainability. Ensuring medium term fiscal sustainability also remains a challenge. Both macroeconomic (in particular fiscal measures) and structural policy responses are needed. Among the remaining structural reforms to improve the functioning of markets, the implementation of bankruptcy procedures should be improved; the regulatory and supervisory framework for on-banking financial institutions must be completed and implemented.

The capacity to cope with competitive pressure and market forces within the Union

Poland's ability to fulfil this criterion depends on the existence of a market economy and a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also requires a sufficient amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union prior to accession. Both the volume and the range of products traded with EU Member States provide evidence of this.

Poland's now well-entrenched market economy continues to allow agents to make decisions in a climate of stability and predictability. The supply side is increasingly modernized as a result of market allocation mechanisms and competitive pressures.

Poland needs to continue building high quality infrastructure to enhance its competitiveness and to avoid bottlenecks (notably in transport infrastructure) to sustained growth in the medium term. At 25% of GDP, the investment ratio is high. However, a closer examination of the determinants on the supply side, in particular investment and productivity, suggests that there are still challenges for ensuring the sustainability of current levels of growth. To date, the investment boom that has contributed to rebuilding quantitatively and qualitatively the capital stock has been financed mainly through retained earnings and foreign direct investment. Over the last two years, however, corporate profitability has been deteriorating. Gross profits in the enterprise sector decreased by some 24% in 1999, while there are a number of sectors that are still loss making. In addition, a large share of FDI inflows so far has been related to privatization. The completion of the current privatization programme in the next few years will necessitate new strategies to attract more green-field investment.

Foreign direct investment inflows are significant and play a major role in the progressive upgrading of Poland's exports and overall competitiveness. Polish sources estimate that inflows could have amounted to ∈8 billion in 1999. Poland, however, did not attract large inflows until 1995, following the agreement on debt restructuring. More than half of cumulative FDI over the last decade occurred after 1997. In view of the lags in the impact of FDI on restructuring and improvements in corporate governance, the current scale of inflows is conducive to increased competitiveness in the medium term. The share of foreign firms in total investment outlays in the manufacturing sector had increased to 56% in 1997. These firms accounted for some 50% of total Polish exports last year. A large share of FDI has been oriented towards non-exporting sectors such as banking, retail trade or construction, partly reflecting the size of the Polish market. In addition, FDI in the services sector can have an indirect beneficial effect on trade by lowering transaction costs and attracting foreign investors in manufacturing.

In general, Poland's markets have become highly contested and open to competition; reflecting trade liberalization and growing market access by its preferential trade partners. However, a number of government policies create market distortions. The presence of state aids is pervasive in both private and state-owned firms and some of the latter do not fully operate under hard budget constraints, including from the point of view of wage setting. Subsidies and accumulations of tax and social security arrears are still present. The presence of non-tariff barriers is also extensive. Poland should resist resorting to instruments of foreign trade policy to address current external imbalances.

The Polish economy needs to further develop its ability to absorb the shocks of industrial restructuring, building upon its level of infrastructure and human capital. In this light, investments will continue to be needed in infrastructure. The system of education and vocational training system should be geared towards responding to the needs of the growing enterprise sector. The implementation of structural reforms in agriculture as well as coal and steel will lead to a shake out of labor that needs to be absorbed in other sectors of the economy.

Active labor market policies appear to have a mixed record on the creation of new employment opportunities, with training being clearly more effective than various forms of subsidized jobs. Training, education and the creation of non-farm jobs in rural areas are key to absorb the excess labor that will be shed from the steel and agricultural sectors where restructuring has so far been insufficient. However, what matters is to improve the response of the labor market to the job opportunities created by economic growth.

Trade integration with the EU is extensive and advancing. The EC accounted for 70.5% of Polish exports last year, compared to 68.3% in 1998. However, the value of Polish exports to the EC, as reported in central bank statistics, increased only marginally last year. Moreover, the increase in the imports of capital equipment, if it is linked to a pick-up in investment and to industrial restructuring, can be expected to lead to a greater capacity to export in the medium term. Wage increase has so far lagged behind productivity increases helping a favorable development in unit labor cost.

Products with higher value added (machine and electrical engineering goods) represent less than one third of the exports of goods in Poland's trade with the EC. There are signs, however, of shifts towards more processed goods. The share of manufactured products in total exports to the EC reached close to 80% in 1998. Moreover, changes in the composition of Polish exports to the EC in terms of factor content suggest a shift towards products requiring skilled labor.

The SME sector is thriving, even though small and medium-sized enterprises still continue to face difficulties in accessing finance. One of the reasons for this is the lack of availability of collateral acceptable to lending institutions. In this area, guarantee schemes are still underdeveloped. The SME sector represents 99% of the total number of firms. It accounts for half of GDP and value-added in the economy, as well as almost two thirds of total employment (see also chapter 16 – Small and medium-sized enterprises).

Poland should be able to cope with competitive pressure and market forces within the Union in the near term, provided it continues and completes its present reform efforts. Progress in structural reforms should help to ease fiscal constraints and allow for high and sustainable growth through increased productivity in the medium term. The pace of privatization has been particularly encouraging in the last year. There has also been progress in restructuring in sensitive sectors such as the coal and defense industries, but large parts of the state-owned enterprise sector still need to be restructured to increase the efficiency and profitability of the overall economy. There are also delays in privatization in the steel sector and the restructuring of agriculture. Urgent measures still need to be taken to improve Poland's infrastructure and to improve the response of the labor markets to changing economic conditions.

2.4. General Evaluation

Poland is a functioning market economy and should be able to cope with competitive pressure and market forces within the Union in the near term, provided it continues and completes its present reform efforts.

It has maintained adequate macroeconomic stability, and its growth performance has again been impressive. The pace of privatization has been encouraging and there has also been further restructuring in sensitive sectors such as the coal and defense industries.

However, a number of economic imbalances have emerged: inflation is high and the current account deficit has widened to a level that raises the issue of sustainability. Ensuring medium term fiscal sustainability remains a challenge. There are delays in privatization in the steel sector and the restructuring of agriculture. Large parts of the state-owned enterprise sector still need to be restructured.

Both macroeconomic and structural policy responses are needed. Fiscal adjustment must take place efforts towards the sustainability of public finances must continue. Among the remaining reforms to enhance the functioning of markets are improvements to bankruptcy procedures and the completion of the regulatory and supervisory framework for non-banking financial institutions. Measures still need to be taken to improve Poland's infrastructure and to improve the response of the labor markets to changing economic conditions.

Overall Assessment

With the entry-into-force of the Polish Customs Code in January 1998 and additional alignment measures since then, Poland has achieved a relatively high level of legislative alignment, whereas its administrative capacity is lagging behind.

Alignment with the acquis still has to be completed, in particular as regards duty relief, customs procedures with economic impact, free zones, dual use of goods and clearance fees. These shortcomings, already identified in previous regular reports, should be addressed as soon as possible.

The administrative and operational capacity of the customs services remains an area of concern. Poland should continue and possibly increase its efforts to implement the business strategy, in a timely and efficient manner. In this context, it is of utmost importance that Poland in the forthcoming years provides sufficient budgetary own resources to facilitate this implementation. As regards shortcomings such as corruption and on-going frequent staff changes, particular attention should be paid to guarantee permanent employment, which is independent from political interference, and a stable staff structure in the Polish customs services.

EXTERNAL RELATIONS

As regards the **Common commercial policy**, since 1999 there has been some progress in alignment of Poland's Commercial policy with that of the EC, for example the replacement of the licensing regime in the automotive sector with a tariff based system. Poland's applied tariffs currently average 16.4% (MFN) on all products, 36.1% on agricultural products, 18.3% on fishery products and 10.9% on industrial products. By comparison, the EC tariffs currently stand at 5.3% on all products, 9.4% on agricultural products, 12.4% on fishery products and 4.2% on industrial products.

Poland is a full and active member of the WTO, a point amply demonstrated by the Trade Policy review of Poland, which took place in July 2000 and where the chairman commented "members (also) appreciated Poland's overall commitment to liberal trade and investment policies". Poland needs to align itself with the EC plurilateral and sectoral obligations upon accession. As regards these obligations, Poland is an observer to the plurilateral WTO Government procurement agreement.

With regard to export credits, an amendment to the Act on export contract insurance guaranteed by the State and a draft law on officially supported export and medium term and long term credits have been adopted and are expected to enter into force within 2000.

As regards **bilateral agreements with third countries**, Poland and Turkey concluded a Free trade agreement on 4 October 1999, which entered into force in May 2000. There ha been no progress in discussion towards an FTA with Morocco. Otherwise, Poland held neither consultations nor negotiations on new trade agreements in 1999.

Within CEFTA, the member countries, including Poland, signed the Additional Protocol No. 8 on the updated version of the Pan-European cumulation of origin of goods.

Poland has not yet adopted legislation on the control of dual-use goods and technologies. In 1999 Poland has started collecting tariff and trade data flows in line with the obligations of WTO agreement article 24.

In the field of **development policy and humanitarian aid,** Poland is an active member of the OECD and it is adapting its development practices to the principles laid down by the Development Assistance Committee.

Overall Assessment

Where alignment with the Community acquis on commercial policy is necessary some progress has been made in the field of export credits.

The EU and Poland have established a framework for co-operation regarding WTO issues both at ministerial and at departmental level. Poland has been supportive of EU policies and positions within the WTO framework, most recently through its Chairmanship of the last Ministerial meeting between the EU and the Candidates counties, which took place in July 2000. As regards the new round, Poland concurs with the EU on the need to launch a comprehensive trade round as soon as possible and shares the view that the results of work under the built-in-agenda would be less substantial in its absence".

Poland is a member of the plurilateral Agreement on Trade in Civil Aircraft and is a signatory to the Information Technology Agreement. However, Poland has not yet acceded to the WTO Government Procurement agreement.

As regards the Agreement for Textiles and Clothing, Poland needs to use the third stage of integration under the ATC to align its integration programmes with those of the EC, while notably avoiding integrating products not yet integrated by the EC. Also, further co-ordination is necessary in order to consolidate the adjustment of the Polish list of commitments in GATS in line with the EC commitments.

In addition to the FTA concluded recently with Turkey, Poland is a member of GEFTA and holds Free Trade Agreements with Estonia, Latvia and Lithuania, the EFTA countries, and Israel. Progress has been made in aligning with the EC's international trade obligations. Poland should continue to keep the Union fully informed about existing trade agreements or negotiations aimed at the conclusion of any new trade agreements with a third country.

Poland will need to bring in conformity with the acquis the Bilateral Investment Treaty concluded with the US. While Poland has committed itself to meeting this obligation, it has not taken specific steps to this end.

Some progress has taken place in the field of export credits. Poland follows the OECD consensus; where medium and long-term credits are granted, further alignment with the acquis is necessary.

Poland's alignment with and future participation in the common commercial policy is administered by the Ministry of Economy. The administrative infrastructure, which needs to be in place as regards customs services, is addressed under the chapter relating to the Customs Union (Chapter 25 – Customs union). Development and humanitarian aid are administered by the Ministry of Foreign Affairs. At this stage no specific issues are to be highlighted in terms of administrative capacity in addition to the analysis presented above.

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