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The polish economic reform - is it on the right track?

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During the post-war period the communist authorities in Poland were trying to find and apply one after another different variants of the same bureaucratic system. All these variants were different combinations of the plan and the market but each of them appeared to be neither a plan nor a market economy. In the 70's and 80's economic chaos set in throughout the country. Disproportions in production were growing, decapitalization processes were accelerating, a discrepancy between the cost of foreign debt servicing and domestic repayment was becoming more and more dangerous, disequilibria on the internal markets were intensifying, state budget deficit stabilized at a very high level and the inflation rate was growing quickly.

The disastrous economic situation was the most important factor which induced the communist authorities to accept an idea of «round table» talks with «Solidarity» at the beginning of 1989. The success of this independent trade union at the June 1989 elections resulted in the first non-communist Mazowiecki Government. Poland embarked on its post-communist reform with one of the most severe open internal imbalances as evidenced by inflation rate of 1'200% in 1989. For instance, an underlying cause of inflation was the subsidization of loss-making enterprises. So, the Government of national confidence responded to the crisis with measures that not only arrested the deterioration but also started to reverse it.

Certainly, Poland has pioneered the region's transition toward capitalism. On January 1, 1990 the Polish Government has launched a wide-spread, radical and market-oriented reform in order to change the very basis of the existing socio-economic and political system. It was a very painful decision to put the sagging communist economy through a «shock therapy» toward market system. In Poland there has started a unique process of building up the democratic system, the state of law, as well as the market economy. Each of them is a very difficult task. All of them at the same time become a tremendously difficult process. There is a commonly shared view that without the democracy one cannot expect to create a prosperous market economy.

The Polish «big bang» reform implied several detailed decisions namely:

- The immediate liberalization of all prices (up to 90% of goods and services).
- The removal of administrative allocation of production factors and the foreign currency (ex.: the introduction of internal foreign curency convertibility).
- The very significant reduction of subsidies.
- The abolition of all quantitive restrictions on imports from the convertible currency area and the introduction of a unified custom tariff for commercial and personal imports.

- The uniformization of tax and credit policies for all sectors and economic agents.

Transforming the economy of Poland (as well as other ex-communist economies) requires a wide range of measures including: 1. macroeconomic stabilization; 2. price, market and trade reforms; 3. private sector development, privatization and enterprise restructuring; 4. extensive changes in the role of state. Most experts think that these reform measures need to be introduced in complementary packages rather than as linear sequence.

The transformation of the rules of economic policy has started under extremely unfavorable institutional conditions like: 1. overwhelming domination of state-owned ineffective enterprises; 2. very high degree of monopolization of the national economy; 3. total lack of market infrastructure (ex.: absence of capital markets); 4. inappropriate tax system and so on. Of course, there were more unfavorable conditions of different character, for instance:

- The transformation has been taking place when the international economic environment is deteriorating.
- The resource allocation has been severely distorted (ex.: incremental capital-output ratio has been incredibly high during the communist period and ratios of investment to GDP that are among the highest in the world have led to very low or even negative growth rate).
- Property rights have not been clearly established.
- There has been a wide-spread lack of undersanding of how market economies operate.
- The poor work habits and attitudes workers have developed under the previous system[1].

There were also a few favorable conditions:

- The strong support of «Solidarity» trade union.

Poland's strong desire for change induces its citizens to support economic policies designed to accelerate growth rates (however, it is true that this political credit becomes more and more limited).

[1] Here I'd like to mention about some most important problems:
- The lack of professional management.
- The lack of professional work organizers.
- The lack of tradition of running small as well as big business.
- «Do it yourself» tradition in nearly all fields of economic activity (agriculture, trade and so on).
- «The standard of living does not result from your work» norm; it means that there is no need to change worker's attitude toward the work efficiency.
- «The man at the top should give you more if you need it and you ask for» norm which means, for instance, that the strike is the best way to achieve a better standard of living.
- «Everyone has the same stomach» norm; it means that income differences must be avoided because they are unjust and socially undesirable.
- «It's not worth studing» or «elites are dangerous for you» norms; they mean that a better education, a higher efficiency or any other criteria upon which a person is different from the others cannot be a better level of living.

- The citizens of Poland are relatively well educated and recent developments have proved that it's a country of enterpreneurial people.
- Poland (as well as other East European countries) is characterized by relatively even income distribution, thus making it unecessary for the state to attempt to redistribute income during the transition period.
- Poland is likely to benefit from its proximity to the European community which offers large and growing markets, financial capital, technology and models on which reformed institutions should be based.

So, it is quite clear that the Polish economic reform has begun in very complex and rather unfavourable conditions (in spite of a few positive ones). After 1,5 year of the implementation of the «Economic Stabilization Program» we may conclude that Poland has gone quite far in two areas of system transformation: 1. the macroeconomic stabilization, 2. the price and market reform. In other areas (private sector development, privatization, enterprise restructuring, redefining the role of the state, etc.) Poland is still at an early stage of the transition.

Let's have a look at the most important results of the 20-month old economic reform:

- In general terms the battle against hyperinflation was rather successful (1'200% in 1989, 50% in 1991).
- Due to restrictive policy of taxes, credits and wages, shortages of goods disappeared.
- The Polish currency-zloty has become internally convertible and stronger; the exchange rate has been relatively stable (9'500 zl = 1 $ till May 1991, since then 11'500 zl = 1 $); it was one of the most important anti-inflationary anchors.
- Global production fell by 43% (in the period June 1989-July 1991); investment fell by 13% (January-December 1990); only private sector continue to grow (19,4% of total industrial production in June 1991 compared to 17,4 % in December 1990).
- Real wages fell by 30% (1990-1991).
- Unemployment appeared; it reached 1,5 million in June 1991 and could possibly reach 2 million by the end of this year.
- Trade surplus in 1990 reached 4,5 billion $ and 7 billion roubles (compared to 800 million $ in 1989); in 1991 this tendency has been arrested.
- There is still very slow inflow of foreign investments.

In sum, we may conclude that the results were rather mixed. Unfortunately, the negative results were more serious than it was expected (ex.: very deep economic recession). However, there is a number of signs that the reform is on the right track. Foreign experts (from the IMF, the World Bank and so on) emphasize that Poland has succeeded in the radical transformation of the market (there are no more shortages, no more queues), zloty is stronger and internally convertible, the fight against hyperinflation was successful, the legal basis for the new market system has been created, some important branches of the national economy have been already privatized (ex.: trade and transportation) and so on. Nevertheless, the Poland of summer 1991 faces a very critical stage of its transition toward the market economy and the fully democratic system. Several new internal elements that did not exist at the beginning of 1990 appeared throughout the period 1990-1991.

In addition to the shock caused by change in its domestic policy, Poland has faced simultaneously three external shocks:

1. The Comecon shock (in January 1990 the USSR announced its intention to terminate the CMEA system as of January 1991 and to introduce hard currency payments).
2. The impact of German economic and monetary union.
3. The Gulf crisis shock.

One could not predict in automn 1989 that a year later Gulf crisis would happen and petrol prices would double, Germany would be unified and exports to former GDR would dramatically fall and that the Soviet economy would totally collapse. Unfortunately for the Polish economic reform all this has happened. The latest and the most serious challenge is the decline of the Soviet economy, Poland's principal trading partner and the decision to tackle the problem head on by introducing a dollar-payment system in January 1991 to replace the old transferable-rouble accounting system. Technically they were ill-prepared for a switch to hard-currency payment and accounting in the Soviet Union. The basic problem is an overall hard-currency shortage. The Soviet Union simply does not have enough money. They are not solvent. With Soviet insolvancy, the EC remains the only viable export market[2]. But there is a limit to the rate at which Poland's trade with the European Community can continue to grow, particularly with trading restrictions on agricultural, textile and steel products. Although the European Community has agreed to lower import barriers for many products, the Polish side contends the EC is attempting to bar Polish imports in the very few areas where Poland has a competitive advantage because of its low labour cost: textiles, which account for 12% of the Polish exports, and agricultural products, amounting to 22%.

One of the main problems continues to be a debt burden despite the unprecedent coup by the Polish President Lech Walesa in March, when the Paris Club forgave 50% of Poland's 33 billion $ debt.

It is clear that the entire process of economic transition depends crucially on political developments. Poland's transition to market economy is now reaching a pivotal phase as public dissatisfaction grows over the very deep recession, the higher prices and layoffs caused by the economic and political transformation. Even as economic changes bear their first fruit in Poland

[2] In 1990 trade between Poland and the European Economic Community almost doubled from 1989, with Poland's exports worth 5,6 billion $ and EC exports 4,7 billion $.

wide-spread protests and strikes are increasing pressure on the government. The number of protests will certainly grow because the authorities will soon have to start closing outmoded and overstaffed enterprises which are too inefficient to survive. The standard of living is expected to decline more before it can get better. Wide-scale demands for salary and wage increases cannot be excluded. The outcome will largely depend on the attitudes of politicians especially before the automn 1991 Parliamentary elections. According to the Deputy Prime Minister Leszek Balcerowicz if the political barriers don't break down Poland can really expect to beat the still too high inflation and to start its economic growth.

There are at least three dangers of the current situation:

1. There is a risk of renewed macroeconomic instability that could derail the entire reform program. The wage pressures are unrelenting, and threaten a renewal of wage-spiral and large budget deficits.
2. The political parties will try to get their tentacles around the state enterprises in Poland.
3. The privatization can become increasingly associated in the public's mind with unemployment. In consequence there could be an electoral response to wide-spread fears of rising unemployment. Rent-seeking behaviour will grow dramatically as political parties get better organized and the privatization process will become increasingly politicized.

Today the country faces a critical stage of its economic reform: the enterprise reform and restructuring with following important steps:

- Clarifying public ownership rights.
- Implementing more effective control over the management of existing firms in part through wide-spread privatization.
- Establishing secure private property rights and facilitating the growth of new private enterprises.

One of the most pressing challenges facing reforming Polish economy is to redefine the role of the state. Its former all-encompassing role must be «unbundled» into separate ownership, financing and regulatory roles. But the ownership reform is proving to be perhaps the most contentious challenge in the entire reform process. The need to accelerate privatization in Poland (and generally speaking in Eastern Europe) is the paramount policy issue. According to Jeffrey Sachs, if there is no breakthrough in privatization of large enterprises in the near future the entire reform process in Poland could be stalled for political and social reasons for years to come. Since July 1990 (when the new basic privatization law was passed) small-scale privatization of shops and other small service units has proceeded very rapidly (some 60'000 shops were either leased or sold in the period 1990-1991). Today around 70% of retail trade is in private hands, and wholesale trade is rapidly being taken over by the private sector. Privatization has also proceeded rapidly in truck transport, domestic wholesale trade, international trade, and construction. Agriculture has long been about 75% privately owned. The government has not yet progressed far with enterprise restructuring. The great majority of the large-scale industrial enterprises remain in public hands (probably 75% of industry by value added remains in state hands).

The intention of the Polish authorities is that by the end of 1993, using conventional and non-conventional[3] methods of privatization, more than one half of the 7'000 state-owned enterprises will be privatized, and that by the end of 1995, the economy will have an ownership structure similar to that of highly developed countries. The problem is if such a program is realistic.

In 1989 President George Bush said that Poles should first of all help themselves and afterwards the international community will try to help them as well (like in the proverb «God helps those that help themselves»). But a transition toward a market economy, after nearly half a decade of economic irresponsibility, appears to be a tremendously difficult task. In its February 1990 Report the International Monetary Fund stated as follows: «In meeting the challenges ahead, the Polish authorities hope for support from the international community, in the form of timely financial and technical assistance on an appropriate scale. If such support is forthcoming and if the authorities continue to be vigilant, the prospects for Poland's economic stabilization and for the restoration of its external viability seem good»[4].

[3] The Polish Government has recently proposed making every citizen a capitalist- by handing over to 27 million adults majority ownership of 400 state-owned factories, representing 25% of the country's industrial sales. The Polish authorities cannot easily sell them because there are no markets to establish fair values. Besides, the process would take decades. The government's solution is to hand over 60% of the equity in each of 400 companies to about 20 investment funds. Ownership of the funds, in turn, would be handed over to every Pole over 18. Initially each adult is to receive vouchers worth one share of each fund. 33% of each company, out of the 60%, would be concentrated in just one investment fund. Over time, investment funds would trade shares in enterprises, leading to stock market where individuals could buy and sell shares on their own.

[4] IMF, «Poland Implements Bold Program», *IMF Survey*, February 1990, p.6.