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## The debt crisis in Poland: Causes, consequences, prospects

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THE DEBT CRISIS IN POLAND - CAUSES  
CONSEQUENCES, PROSPECTS

by

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June 1986

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THE DEBT CRISIS IN POLAND - CAUSES,  
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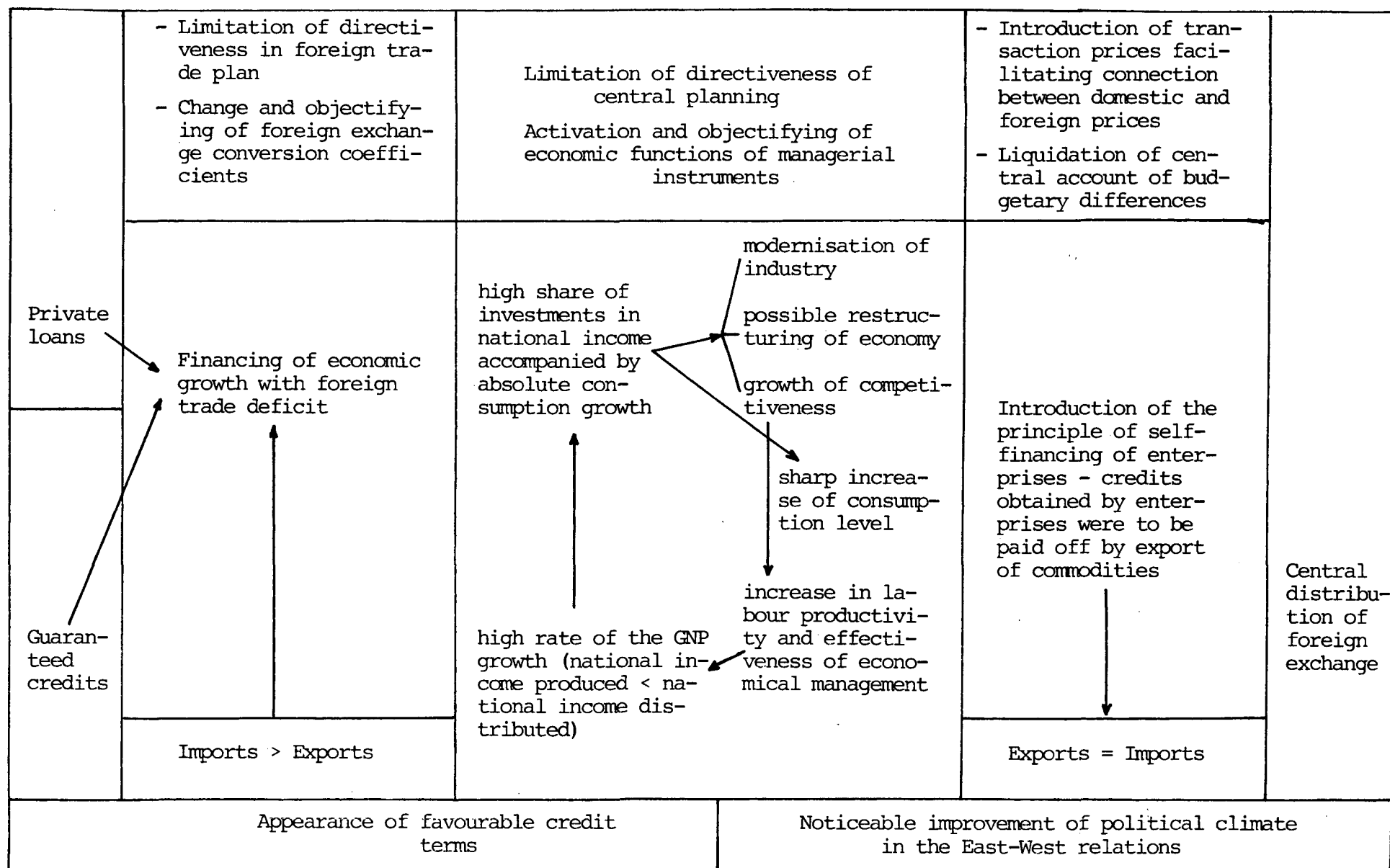
The early seventies brought about important social and political changes in Poland. The changes were responsible for a fundamental reorientation in the conception of the strategy of socio-economic development. The aim of this strategy was the acceleration of socio-economic progress, i. e. a thorough modernisation of the Polish economy, rise of its international competitiveness and a rapid growth of consumption. These objectives were to be accomplished by a dynamic growth in the national income facilitating both the acceleration of investment rate and the absolute growth of consumption level (Diagram 1). The structure of investments was to determine a gradual restructuring of the national economy. The increasing significance of the motivating role of wages was to promote a more effective and more efficient work force. This in turn, due to the cumulating feedback, was to maintain a fast rate of national income growth.

The new strategy assumed that the directing role of central planning would be gradually restricted and the economic functions of the basic managerial instruments would be activated and objectified. Moreover, the new strategy anticipated the activation of foreign trade which would influence economic growth and transform its typically supplying function so that it would facilitate the reduction of the GNP production costs. Imports were to result in the growth of internal accumulation and change its structure. Apart from this the inflow of credits comprising both private loans and government guaranteed credits was assumed. Such an assumption was justified by extremely favourable credit conditions which appeared at the beginning of the seventies (the rate of interest on the Eurocurrency market approximated 5 percent). The governments of economically developed countries granted transaction credits at an annual interest rate of 6-8 percent in order to promote exports<sup>1</sup>. Loans were abundantly available and this phenomenon was enhanced by the recycled petrodollar credits after the rise of oil prices in 1973/74.

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<sup>1</sup> Compare: M. Minkiewicz, Bilans dwóch lat kryzysu zadłużenia międzynarodowego (The Balance of the Two Years of the International Debt Crisis), "Handel Zagraniczny", N° 11-12/1984, p. 29.

Diagram 1: Functioning of the Polish Economy in the 1970s (assumptions of the development strategy)



Among the external factors in the change of Poland's approach towards the "openness" of her economy, quite a significant role was played by a noticeable improvement of the political climate in the relations between the East and the West.

The new approach to the role of foreign trade in the national economy also provided for certain changes in the management of exchange with abroad. These changes were to increase the flexibility of the Polish economy in its contacts with other economic systems. They comprised the further limitation of the directive nature of foreign trade planning and brought managerial instruments closer to reality. The exchange rate was to have a price-creating function and the central account which automatically levelled the differences between domestic and foreign prices was to be liquidated.

As far as the accomplishment of the macroeconomic objectives is concerned, it is impossible to give a univocal evaluation of that period. There is a noticeable difference in this respect between the first and the second half of the seventies (see Table 1).

The internal feedbacks between particular economic categories of the national economy were practically convergent with the assumed conception of development only in the first subperiod of the seventies. The second subperiod of the seventies was characterised by the decline in the majority of the economic growth indicators.

The realisation of the developmental conception for the seventies was largely possible due to the import of all kinds of commodities financed with credits from developed capitalist countries. The imports in question considerably exceeded the previous plan assumptions. Thus, the five-year plan covering the years 1971-1975 assumed an import surplus of Zł 2.5 billion. Actually, within this short space of time the import surplus reached Zł 20 billion. The same thing happened when the successive five-year plan (1976-1980) was realised. The excess of imports over exports was to reach Zł 7 billion. The trade deficit in that period was four times higher than planned as it amounted to Zł 28.3

Table 1: Indicators of Poland's Economic Growth, 1971 - 1980

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
	percentage change from previous year									
National income generated	8.1	10.6	10.8	10.4	9.0	6.8	5.0	3.0	-2.3	-4.0
National income distributed	9.8	12.7	14.3	12.1	10.9	7.0	2.7	0.7	-3.4	-6.0
Industrial production sold	8.8	10.2	12.0	12.5	12.6	10.7	8.8	5.9	2.9	-1.3
Total agricultural production	3.6	8.4	7.3	1.6	-2.1	-1.1	1.4	4.1	-1.5	-10.5
Exports	6.2	15.5	11.6	12.3	8.3	4.4	8.0	5.7	6.8	1.0
Imports	14.3	21.8	22.8	14.9	4.4	9.6	-0.1	1.8	-0.9	-3.7
Social productivity of labour	6.9	8.6	9.0	8.2	8.3	7.7	5.0	3.3	-1.5	-3.0

Source: W. Trzeciakowski, Handel zagraniczny: diagnoza i terapia (Foreign Trade: Diagnosis and Therapy), "Handel Zagraniczny", N° 7/1981, p. 3.

billion<sup>2</sup>. In practice there was no feedback between the imports of technologically advanced investment products and the stimulation of exports aimed at bringing the balance of turnovers to equilibrium. Exploitation of the financial means borrowed for imports was partially responsible for this. Out of the total amount of credits which were granted to Poland in the seventies only 20 percent were allocated for investment outlays. Only this part of credits could, therefore, have a meaningful influence upon the growth of effectiveness of the national economy. The major part of credits (about 65 percent) was allocated for the import of supplies mainly to make possible the functioning of the investment equipment imported. The remaining part of credits (about

<sup>2</sup> For more details see A. Dorosz, Z. Królak, Polityka płatnicza Polski wobec krajów kapitalistycznych (The Polish Policy of Payments towards the Capitalist Countries), "Handel Zagraniczny" N° 7/1981, p. 13.

15 percent) was used for the indispensable supplementary imports of agricultural products which included, above all, various kinds of fodder<sup>3</sup>.

Exceeding the planned value of imports and their structure hindered the occurrence of the feedback which was supposed to stimulate the growth of export production so that the equilibrium in the balance of payments would be restored. As a result of this the debt run up could be observed in Poland throughout the seventies (see Table 2).

In the course of time the joint amount of debts highly exceeded the cumulated foreign trade deficit. This was due to interests and the accumulation of payments connected with the service of debts. An ever increasing part of export returns had to be allocated for the above mentioned liabilities which were responsible for the increasing demand for credits to finance import supplies. The amount of transaction credits began to increase. They financed mainly provisional imports and imports of agricultural products and were generally contracted for short and medium terms at a high rate of market interest. These terms were not adjusted to the pay-back periods of investment outlays the realisation of which was based upon the imported know-how and equipment. The circle of the "debt trap" was gradually closed. This process became dramatically apparent in the mid-seventies when credits were contracted by the country in order to maintain its balanced international payments<sup>4</sup>. Thus in the course of the seventies the conception to finance economic growth through the foreign trade deficit and to allocate credits for the financing of the service of debts, repayment of interests, and the maintenance of balanced international payments was gradually abandoned.

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<sup>3</sup> Compare: A. Bień, *Rola kredytów zachodnich w rozwoju gospodarczym Polski w latach siedemdziesiątych* (The Role of Western Credits in the Economic Development of Poland in 1970s), "Handel Zagraniczny", N° 8-9/1981, p.8.

<sup>4</sup> A. Dorosz, Z. Królak, *op.cit.*, pp. 13-14.



Table 2: The State of Polish Debts at the End of the Year according to the Statistics of the National Bank of Poland (Mio. \$)

Year	Debt	Year	Debt
1971	1189	1976	12149
1972	1384	1977	14927
1973	2625	1978	18432
1974	5224	1979	22262
1975	8388	1980	24720

Source: St. Jędrychowski *Zadłużenie Polski w krajach kapitalistycznych* (Polish Debts in the Capitalist Countries), KiW, Warszawa 1982, p. 152.

The above mentioned causes directly affected the accumulation of Polish debts. The antecedents of the debt crisis, however, were much more complex and more deeply rooted. They may be divided into internal and external premises.

#### 1. Internal premises

a. Errors in the control of the national economy resulting from the absence of a conception of Poland's participation in the international division of labour were committed:

- There was no control over the balance of payments resulting from the fact that import decisions did not consider the safety limit which is commonly acknowledged in international economic relations when a country runs into debts. The international economic practice shows that the safety limit in debt run up is the ratio 20-25 percent of the yearly cost of foreign debts' service (comprising the amount of repayments plus interests) to the yearly export returns of a country. This level was exceeded in Poland as early as the mid-seventies (see Table 3). Simultaneously, by the middle of the period in question, the joint value of debts in convertible currencies surpassed the value of exports to the capitalist countries by nearly one third. In this case the ratio 1:1 was, for the time being, assumed to be the safety limit of the debts incurred. This means, at the very most, that the

joint value of debts equalled the yearly returns from exports of goods and services<sup>5</sup>.

- There was no orientation of the credit flow at the restructuring of the national economy in favour of a pro-export specialisation. This resulted from the absence of a conception as to the role foreign trade should play in the national economy. The foreign trade was treated instrumentally. The conception to finance economic growth through the foreign trade deficit was not accompanied by a conscious modification of the economic structure to achieve the maximum advantages connected with participating in the international division of labour. The ways of credit utilisation were largely decided by the so-called branch lobbies which steered the flow of credits to the most powerful branches. These were most often highly material- and energy-consuming branches, inherited from the previous strategy of development. As a result, the flow of credits was considerably scattered and often allocated for ineffective investments and the pointless purchasing of licences<sup>6</sup>.
- There was no understanding of the impact external factors exercise on foreign trade and balance of payments since there was no concept as to the participation in the international division of labour<sup>7</sup>. No account was taken of the possibility of fundamental changes in the world's business conditions. The Polish economy revealed a complete lack of adjustment to the change in business conditions which had resulted from the petroleum price shock of 1973/74. Poland was not prepared for the possibility that the economic crisis in many developed countries would result in the introduction of protectionist policy which particularly concerned the imports of goods from the

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<sup>5</sup> Compare: Rządowy raport o stanie gospodarki (The Government Report on the State of Economy), "Trybuna Ludu", Warszawa, July 1981.

<sup>6</sup> For details see S. Gruzewski, Źródła zadłużenia zagranicznego i jego autorzy (The Source of Foreign Debts and its Originators), "Handel Zagraniczny", N° 11/1980.

<sup>7</sup> The outstanding Polish economist J. Pajestka gives an outright statement that "the specificity of economic powers and mechanisms occurring on the capitalist market in 1970s has not been understood in Poland" (J. Pajestka, Kształtowanie procesu rozwoju. Racjonalność i manowce polityki (Shaping the Process of Development. Rationality and Misguidance of the Policy), PWE Warszawa 1983, p. 200).

Table 3: Share of Exports Burdened with the Repayment of Credits plus Interests

Year	Percent of Exports	Year	Percent of Exports
1971	20	1976	41
1972	18	1977	55
1973	17	1978	76
1974	24	1979	94
1975	32	1980	101

Source: St. Jędrychowski, *Zadłużenie Polski w krajach kapitalistycznych* (Polish Debts in the Capitalist Countries), KiW, Warszawa 1982, p. 153.

socialist countries. Apart from that the influence of the terms of trade upon the situation in the balance of payments was not taken into consideration. However, as it is shown below, the relations of the price terms of trade were not unfavourable for Poland throughout all the seventies (see Table 4). The fact that with a big foreign trade deficit even the favourable terms of trade cause a spontaneous aggravation of this deficit passed unobserved<sup>8</sup>. Besides, the influence of various factors on the flexibility of credit terms was not fully understood. No account was taken of the eventual adverse effects which might result from the increase of interest rate or inapt choice of credit currency.

- b. The effectiveness of managerial instruments and planning of the national economy (inclusive of the foreign trade) was low.
- The economic management based upon a directive-distributive system was continued. The assumptions of the general conception of development concerning decentralization of decision-making were not put into practice in the seventies. The directive-distributive system based upon directives passed authoritatively by the Centre substantially restrained the initiative of executive levels.

<sup>8</sup> Compare: A. Bień, *Planowe wyznaczanie wielkości ujemnego salda bilansu handlowego* (Planned Evaluation of the Foreign Trade Deficit), "Handel Zagraniczny", N° 4/1981.

Table 4: Relations of the Price Terms of Trade in Poland's Foreign Trade in 1971-1979

Compared with....	1971	1972	1973	1974	1975	1976	1977	1978	1979
..the previous year	104.3	101.8	97.1	99.5	103.2	102.0	97.7	100.0	97.5
..1970	104.3	106.2	103.9	102.5	102.4	104.4	102.1	103.8	100.7

Source: St. Jędrychowski, *Zadłużenie Polski w krajach kapitalistycznych* (Polish Debts in the Capitalist Countries), KiW, Warszawa 1982, p. 99.

Since there was no connection between the financial results of an enterprise and the conditions of its functioning, no one was interested in increasing the effectiveness and productivity of labour. Because of this the results of the economic calculus were only a marginal criterion for the decisions made. Moreover, the planning system revealed the lack of connections between the annual and five-year plans. The plans for enterprises were hierarchically subject to the central plan. Under the conditions of commonly granted central subsidies, central distribution of quite easily available foreign exchange and directive imposition of plan assignments, the economic responsibility of microeconomic units for the decisions made was minimised. This led to the excessive expansion of investments, the shift of the investment realisation in time, the formation or deepening of the energy- and material-intensive production, etc. By steering the economy in such a way the ineffective system of management and planning must have resulted in certain tensions which occurred in the internal equilibrium and which simultaneously aggravated debt tendencies.

- There was no consequence in carrying out the process of integration between the foreign trade and the total activities of industrial units. The majority of industrial enterprises had to apply for the mediation of specialistic foreign trade enterprises. The strict product monopoly

of the latter was responsible for the fact that the bargaining position of productive enterprises in relation to an intermediary foreign trade enterprise became weaker. Except for a short period in the early seventies, there was practically no integration between the financial results obtained from foreign trade and those from productive units. This was largely due to the decreasing importance of transaction prices and their influence on domestic prices. It resulted in a small self-dependence of enterprises in their adjustment to the conditions of the international market. Moreover, it reduced their interest in exports and was responsible for the lack of mechanisms promoting the rational use of imports.

c. Errors in internal economic policy were committed.

- There was no control over the proper correlation between the rate of income growth and the rate of the national income growth, labour productivity and level of prices. The unusually strong increase of wages and incomes of the population which occurred particularly in the first half of the seventies was not accompanied by an adequate rate of production of consumer goods and increment of labour productivity. Simultaneously, mainly because of the social pressure, there was no active price policy which could have been an instrument to maintain internal equilibrium. Thus, the inflationary gap widened. That process was intensified particularly in the second half of the seventies. In 1980 the sharp growth of incomes by 30 percent was accompanied by a 6-7 percent decline in commodity supplies to the market. As a result of this, the inflationary gap became much wider<sup>9</sup>.
- Errors were committed in agricultural policy. Apart from objective causes connected mainly with unfavourable weather conditions, the errors in agricultural policy were the basic determinants of stagnation and decline in agricultural production in the second half of the seventies. These errors consisted in the under-investment of agriculture: the lack of adequately modern machinery, tools, component parts as well as insufficient supplies of fertilizers, pesticides and fodders. This was aggravated by disproportions

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<sup>9</sup> J. Górski, *Gospodarka 1981. Elementy diagnozy* (The Economy of 1981. Elements of Diagnosis), "Życie Gospodarcze", N° 1/1982.

between the retail and purchase prices of farm products which hindered the proper motivation to increase agricultural production. As a result, the agricultural production did not satisfy the demand for farm products, thus exerting a pressure to import them. Within the seventies Poland purchased approximately 8 billion dollars worth of crops and fodders which substantially contributed to the burdening of her balance of payments.

- The investment rate was too fast which caused the scattering of financial means and prevented the self-financing of the credits contracted. It has been estimated that in the period 1970-1976 the investment outlays in Poland rose from Zł 270 to 613 billion per annum<sup>10</sup>. Such a rate was not adjusted to the level of development of the economic infrastructure. This resulted in the prolongation of the building cycle of the new plants and in the freezing of huge financial means. In 1980 the value of frozen machinery and equipment amounted to nearly Zł 50 billion. About 70 percent of those had been imported<sup>11</sup>. There was no modernisation of the old works as the stress was laid on investing into new huge plants. The lengthening of investment cycles and the progressive loss of internal balance resulted in the exemption of enterprises from self-financing of the credits contracted. This hindered the growth of exports and aggravated the situation in the balance of payments. The investment policy neglected a number of basic branches of the national economy with agriculture on top of the list. The main focus of interest concentrated on heavy industry and raw materials industry, the investments cycles of which are very long by nature and span 7-8 years.

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<sup>10</sup> J. Górski, *Gospodarka 1981. Problemy załamania i rozwoju* (The Economy of 1981. The Problems of Breakdown and Growth), KiW, Warszawa 1982, p. 7.

<sup>11</sup> S. Gruzewski, *op.cit.*, p. 7.

## 2. External premises

- a. A recession occurred in the developed capitalist countries. A characteristic feature of the second half of the seventies was the fact that the economics of the developed capitalist countries entered the slowdown phase of their economic growth. In the period 1974-1983 the rate of economic growth was nearly 2.5 times smaller than in 1960-1973<sup>12</sup>. The decline in employment and the increase of inflation were aggravated, which affected the general imports of these countries.
- b. The trade policy of the developed capitalist countries discriminated against the socialist states. Apart from a somewhat automatic weakening of imports, the economic recession in the developed capitalist countries also resulted in a certain intensification of protective tendencies. This, first of all, affected the socialist states and concerned mainly the trade restrictions imposed by the EEC whose member states were Poland's chief trading partners among the developed capitalist countries. In the absence of bilateral trade agreements, the move of the EEC trade policy towards the socialist states was carried on autonomously and comprised, among others, extra-tariff barriers, more severe quota restrictions on imports from the socialist countries, subsidies for the production of "traditional" branches which compete with imports from Poland, variable compensation charges imposed on imports of farm products which for years had been exported by Poland, and the like. Moreover, the extension of trade preferences for certain Mediterranean countries, granting general preference tariffs to developing countries (inclusive of the former colonies) as well as establishing (in a joint effort with the EFTA member states) the West European zone of free trade in industrial goods also contributed to the substantial reduction of Poland's "manoeuvring" possibilities in her access to the markets of those countries within the framework of the existing structure of her exports<sup>13</sup>. This reduced to some extent the chances of alleviating the

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<sup>12</sup> "European Economy", N° 18/1983, p. 206.

<sup>13</sup> For details on trade policy of the developed capitalist countries see A. Muńko, W. Rybowski, *Polityka handlowa Europy Zachodniej wobec krajów socjalistycznych: zasadnicze problemy i próby ich*

financial burden of Poland which existed mainly in her trade with the countries in question.

- c. The costs of credits contracted in the capitalist countries increased. The acceleration of inflation which occurred in the economically developed countries in the seventies and were caused, among others, by the energy crisis and the rise of prices for energy-intensive raw materials resulted in the rise of Western credits' costs. In the peak period the New York prime rate exceeded the level of 20 percent. The London LIBOR rate reached a similar level<sup>14</sup>. To Poland, whose financial standing continually worsed in the course of the seventies, this also meant the rise of all kinds of other charges, i.e. the aggravation of the balance of payments situation.

The causes presented above determined to varying degrees the acceleration of Poland's debt accumulation. Putting aside the ambition to define the influence of particular factors upon the balance of payments situation, one can generally say that the premises of internal character played a decisive role in this respect<sup>15</sup>. The external premises were only of secondary importance. They aggravated the inefficiency of the feedback occurring between the internal and external system. However, they cannot be treated as the basic element affecting the heavy financial burden which appeared in Poland's trade relations with abroad. The truth of the commonly known principle has been confirmed: the eventual advantages resulting from the participation in the international division of labour require at first a reformation of the internal system of the national economy so that it would facilitate the adaptation to the realities and requirements of the international market. The opening of the economy brings about fundamentally different qualitative conditions for the

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rozwiązań (West European Trade Policy Towards the Socialist Countries: Basic Problems and Attempts to Solve Them), "Handel Zagraniczny", N° 7-8/1984.

<sup>14</sup> M. Minkiewicz, op.cit., p. 30.

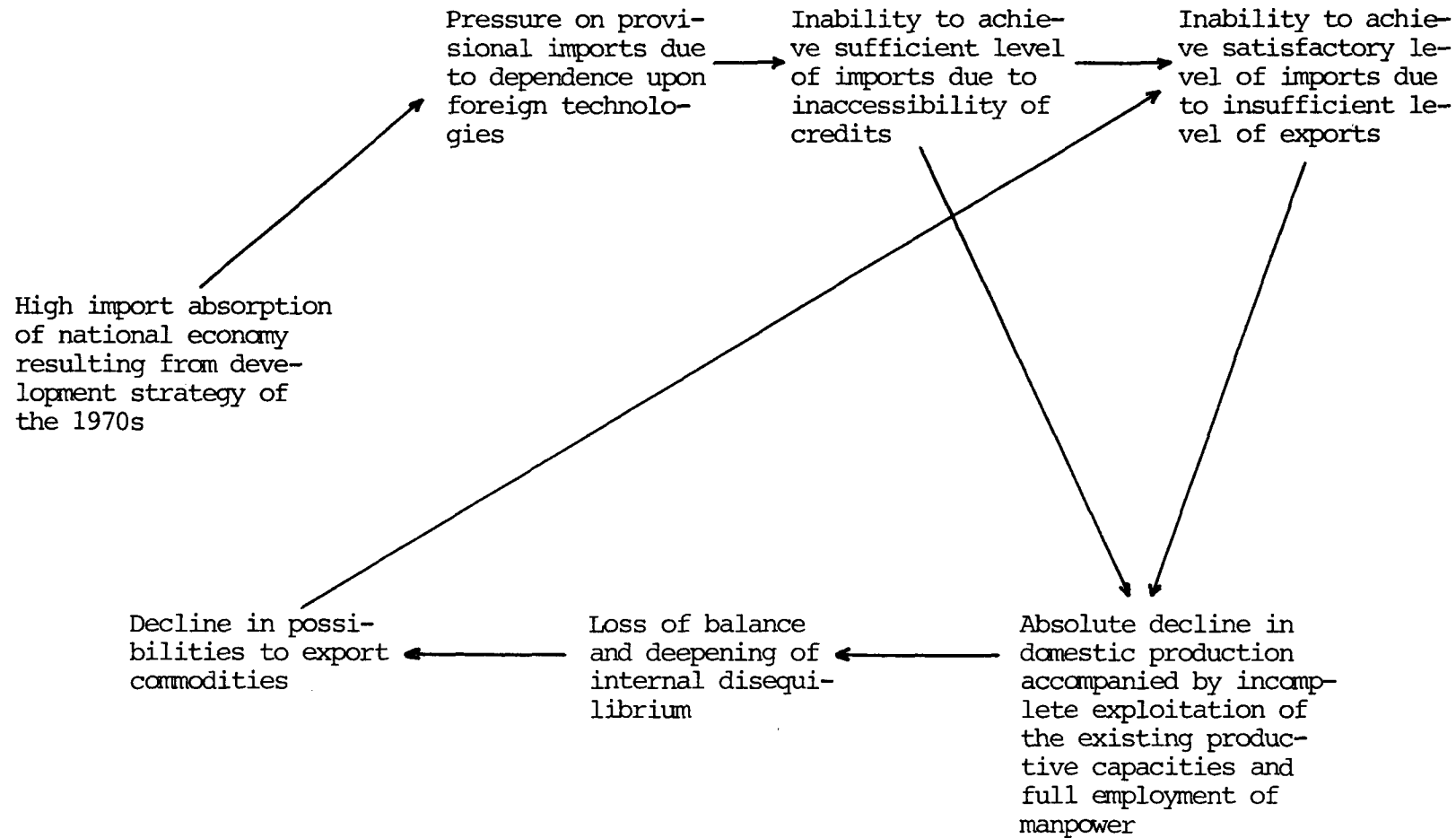
<sup>15</sup> This fact has been generally confirmed in the Polish economic literature. Among other works see J. Dembowski, Zewnętrzne uwarunkowania strategii rozwoju (External Conditioning of the Strategy of Development), "Handel Zagraniczny", N° 9/1983, p. 12; K. Zabielski, Zadłużenie a polityka gospodarcza w latach osiemdziesiątych (Debts and the Economic Policy of 1980s), "Handel Zagraniczny", N° 8-9/1981, p. 5; S. Gruzewski, op.cit., p. 4.



allocation process steered by the macroeconomic level and for the decision-making process at the microeconomic level. A wider opening sets higher requirements for the efficiency of its functions at all levels of management. In the seventies this fact was not fully realised and appreciated in Poland. The country sustained its first bitter experiences from the rapid opening of the economy and from involving foreign trade into the process of economic growth.

The accumulation of debt exercised a direct influence upon the general economic crisis which occurred in Poland at the beginning of the eighties. The background for this crisis was provided by foreign trade barriers. With a high import absorption of the Polish economy resulting from the developmental strategy of the seventies and with the rising costs of the debt service, the country's exporting possibilities proved insufficient. The potential possibilities of exporting goods abroad were additionally weakened by holding up medium- and long-term credits by Western creditors. This affected the imports of materials indispensable for export production (Diagram 2). Apart from that, Poland's potential exporting possibilities were adversely affected by the economic restrictions imposed by the governments of the Western states, particularly by the USA. These restrictions prevented Polish-made products from entering the markets of the countries in question. The reduction of exporting possibilities was aggravated by disturbances in the functioning of the economy resulting from socio-political events as well as by the fact that no essential structural changes had been made in the managerial system. Given the incomplete exploitation of the country's productive capacities and full employment of manpower, an absolute decline in the level of the national income produced occurred. The productivity of labour decreased and the inflationary gap in the domestic market substantially increased. This resulted in the pressure to reduce the volume of exports by switching a part of goods from the export to the domestic market. The reduction of exports lowered the level of foreign exchange funds in cash. Those were the only means to carry on the supply of imports which were indispensable for the functioning of industry. The "circle" of negative feedbacks at the point of contact between the internal system and the external system closed. In 1981 Poland temporarily suspended the service of debts.

Diagram 2: Feedbacks in the Functioning of the Polish Economy at the Beginning of the 1980s



In order to weaken the adverse effects of the above mentioned feedbacks upon the functioning of the national economy, some action had to be taken both in the internal sphere and at the point of contact with the external environment. However, the effectiveness of the latter depends only to a certain degree on the debtor country. A schematic diagram presented below contains elements for the functioning of the national economy, its management, the role and management of foreign trade as well as those pertaining to the external environment (Diagram 3). From the viewpoint of current restrictive conditions influencing the conception of development, these actions seem to be the optimum ones in the efforts to diminish the negative effects of debts on the national economy and to fix up financial relations with foreign creditors. Fixing up financial relations may literally mean a regular service and repayment of debts. The other sense of the phrase comprises a defined long-term policy concerning the balance of payments and a precise definition of the role of foreign trade in the process of economic growth. Some of the measures presented here have already found an institutional and legal solution and have been (or are being) implemented in Poland at present. Other encounter either external or internal barriers of consciousness or conceptional doubts.

Among the steps of internal character special attention must be paid to elaborating the conception of a coherent economic reform and realising it gradually. The fundamental assumptions of this reform are based upon a substantial decentralisation of the managerial system. The reform provides for a considerable freedom of enterprises in the field of independent decision-making and self-financing. Substituting directives with economic mechanisms should activate the decisive role of the economic calculus at the microeconomic level. This, in turn, should stimulate the rise in effectiveness of the national economy. The principles of the economic reform in the foreign trade sector were subject to the above mentioned objective as well as to the promotion of exports, the economic use of imports and restoration of equilibrium in the balance of payments. Among other things, the principles of the economic reform in the foreign trade sector comprised<sup>16</sup>:

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<sup>16</sup> Compare: U. Płowiec, *Handel zagraniczny*, seria: *Polska reforma*

Diagram 3: Internal and External Elements Affecting Functioning of the Polish Economy in the Phase of Overcoming the Debt Crisis

Private loans	<ul style="list-style-type: none"><li>-Independent planning of central and executive levels</li><li>-Extension of price-creating function of exchange rate and its consequent objectifying</li></ul>	<p>Consequent reformation of management and planning of national economy</p> <p>Decentralisation of decision-making</p> <p>Principle of self-dependence and self-financing of enterprises</p> <p>Economisation of managerial instruments</p> <p>Activation of decision-making role of economic units</p>	<ul style="list-style-type: none"><li>-Perspective introduction of convertible currency</li><li>-Extension of functioning of transaction prices</li></ul>	Gradual abandoning of central distribution of foreign exchange	
Guaranteed credits	Achieving current surplus of exports over imports. Growth rate of exports $\geq$ growth of international discount rate, and growth of foreign trade deficit $<$ international inflation rate	<div><div>maintaining the share of investments in the national income in accord with economic possibilities</div><div>↑</div><div>gradual increase of the national income in the course of removing barriers to economic growth (national income produced <math>&gt;</math> national income distributed)</div><div>↗</div><div>restructuring of economy aimed at enhancing its pro-export character</div><div>↓</div><div>stabilisation and perspective rise of consumption level</div><div>↘</div><div>systematic increase of labour productivity and effectiveness of economic management</div></div>	Development of rational substitution of imports		Increasing the share of enterprises in exploitation of foreign exchange funds obtained from their own exports and allocated for their own import needs
Credits of international organisations and institutions (IMF)					
Negotiations on re-financing of debts	Revival in international economic development	Participation in initiatives promoting improvement of political climate in the East-West relations	Renegotiation of formula of participating in GATT	Joining trends of world technological progress by intensification of, e.g., co-operative processes	
Attempts to join IMF in order to obtain credits easing financial tensions		Expectations for lifting economic restrictions	Waiting for trade partners to lift protective burdens		

- the activation of the role of the foreign exchange rate by investing it in possibly the widest price-creating function. The introduction of a uniform rate was provided for the future. Apart from that, plans were made to introduce convertibility of the Polish currency after having reached a relatively rational state of indebtedness and internal equilibrium;
- the extension of transaction prices obtained in exchange with abroad over domestic sales price formation;
- the autonomous character of enterprise plans pertaining to the sphere of turnover with abroad as well. Ensuring a relative concurrence between the central plan of foreign trade and the autonomous plans of enterprises should mainly involve the application (on the part of the Centre) of indirect instruments of management (rates, prices, duties, subventions, etc.), direct means in the gestion of Foreign Trade Minister (e.g. customs quota, import and export permits) as well as orders for export goods placed by the Foreign Trade Minister;
- the authorisation of exporting enterprises to receive foreign exchange means from the bank in accordance with the standards proportional to the value of the goods exported;
- the following differentiation in the status of ownership of the foreign trade enterprises: state enterprises, co-operative societies, capital associations with domestic or foreign capital and private firms.

The conception of functioning of the national economy assumes a gradual growth of the national income which is expected to increase as barriers to economic growth are removed (Diagram 3). The share of investments in the national income should correspond with the real economic possibilities. On the one hand, the share of investments in the national income must not contribute to the current aggravation of the internal disequilibrium. On the other hand, it must not result in the decapitalisation of the national property. The structure of investments should not consolidate any structure of production which is ineffective and unadapted to the country's participation in the international

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gospodarcza (The Foreign Trade, from a series on: The Polish Economic Reform), PWE, Warszawa 1982.

division of labour. The structure of investments should shape the pro-export character of the production structure, not only in view of paying off the debts incurred but also because of the objective necessity to join and employ the world trends of technological progress in the progress of economic growth. This could increase the competitiveness of Polish products on foreign markets and facilitate the growth of import possibilities. Side by side with maintaining a rational relation between the share of consumption and the share of investments in the national income, such directions in restructuring the national economy which would result in the above mentioned effects could contribute to the stabilisation and perspective rise in the living standards. The restructuring understood in this way, together with changes in the managerial system, may directly promote the increase of labour productivity and effectiveness of economic management. Due to the motivational impact of the market, these magnitudes may be indirectly promoted by the growth of potential consumption possibilities. In such a case the level of the national income will be raised through the exploitation of intensive, not extensive factors.

The foreign trade plays a specific role. The conception of current development provides for the influence of foreign trade upon the weakening of barriers to economic growth which appeared in the 1970s. While defining the role of foreign trade in the present and perspective functioning of the Polish economy, it is necessary to consider a few conditions which restrict the possible freedom of this sector's influence upon the national economy. On the one hand, a great amount of debts determines the necessity to conduct a policy of current surplus of exports over imports. With the insufficient exports of the Polish economy, such a policy requires a parallel rationalisation of imports. On the other hand, both the stimulation of exports and the substitution of imports limit the internal possibilities for accumulation and the adverse influence on the internal equilibrium. In perspective, this may curb the path of economic growth and impose even more severe restrictions on exports. In the case of the substitution of imports, its negative impact upon internal equilibrium may result from the decline in effectiveness of the economic management due to the replacement of imported goods with domestic products which do not come up to all quantitative and

qualitative requirements of the production process previously directed at the import of supplies. Moreover, the substitution of imports means also the use of resources which could be exploited in other fields, particularly those of pro-export character. Because of this, the rationalisation of imports must be carried on with special care and must not simply mean the automatic curtailment of imports. Bearing in mind all the numerous limitations, it is extremely difficult to find the optimum solution. Treating the reduction and perspective liquidation of the deoptimizing impact of debts upon the functioning of the economy as the primary objective, one should nevertheless aim at a gradual improvement of the balance of payments. The minimum accomplishment in this respect should be to make the rate of export growth at least equal to the international discount rate. At the same time it should be ensured that the growth of indebtedness does not exceed the international inflationary rate<sup>17</sup>. Going beyond the two limits would mean a shift in time and aggravation of the negative influence of the balance of payments upon the functioning of the economy.

The Polish economy of 1984 has not yet achieved such a surplus of its exports over imports from the free exchange countries which would make it possible to complete the current repayment of credit interests. In 1984 the joint value of Poland's indebtedness towards the above mentioned states reached the level of 26.9 billion dollars. With the average interest rate of 10 percent, the very repayment of interest required about 2.7 billion dollars. The value of exports was estimated at 5,8 billion dollars which means that in order to realise the complete repayment of that year's interest, imports should have been reduced to the mere level of 3.1 billion dollars. In practice the value of imports from the free exchange countries reached the level of 4.4 billion dollars which is regarded as the minimum limit of satisfying the most indispensable export needs. Therefore, after paying 1.7 billion dollars of interest the joint value of Polish debts in 1984 increased by 1 billion dollars. The sum of interest in arrears is assumed to get smaller and smaller and the value of debts should stop growing. It is assumed that this objective will be accomplished by 1990/91 at the

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<sup>17</sup> Compare: J. Dembowski, *op.cit.*, p. 12.

latest. If the interest rate is stabilised, then the total debt should not exceed 35 billion dollars<sup>18</sup>.

The mollification of the influence of the heavy balance of payments burden on the functioning of the Polish economy also requires the occurrence of appropriate changes and positive tendencies in the external environment:

1. Credit terms on the international currency market

At present Poland has only slight possibilities for the credit financing of her imports. The majority of debtor countries took a decision to stop credit supplies for Poland. This decision has been realised since 1982. Following the governmental decision, private banks stopped credit operations as well. In order to postpone the negative impact of the financial burden upon the national economy, Poland started negotiations on restructuring her debts. Talks on non-guaranteed credits conducted with the representatives of over 500 commercial banks ended favourably. The agreements signed resulted in a regulation of paying off the obligations for 1982, 1983 and those for 1984-1987. The agreements in question comprised all credits which had not been guaranteed by the governments of creditor countries<sup>19</sup>.

However, negotiations with the governments of the countries which belong to the Paris Club were broken due to the economic sanctions imposed by those countries upon Poland. As a result, in the period 1982-1984 Poland did not pay her obligations on the score of guaranteed debts. At the beginning of 1984 the negotiations were resumed and they resulted in a preliminary agreement on the restructuring of repayments for 1982-1984. They are to be spread over 11 years<sup>20</sup>. After the problem of regulating the repayment of Poland's financial obligations had been solved, there emerged some possibilities of an access to both non-guaranteed and guaranteed credits with the prospect of developing the country's export potential. Moreover, Poland has applied for admittance to the International Monetary

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<sup>18</sup> All data from "Polityka-Eksport-Import" N° 5/1985, p. 18.

<sup>19</sup> For details see B. Sulimierski, Światło w tunelu (The Light in the Tunnel), "Polityka-Eksport-Import", N° 4/1985, p. 19.

<sup>20</sup> As above.



Fund. If her application is accepted, the potential possibilities to obtain credits with favourable terms from this organisation will increase.

## 2. External business conditions

All estimates show that one should not expect a rapid boom in the world economy. The domination of oil in the international energy balance subordinates the process of development to the consumption of this raw material. The mean yearly rate of international economic growth is assumed to oscillate within the limits of 2,5-3,0 percent<sup>21</sup>. This does not necessarily mean that one has to expect this factor to exert a particular pressure on the growth of imports comprising Polish products as well. It does mean, however, the necessity to increase the competitiveness of goods resulting from higher quality and restructuring the process of adaptation to the changes in international demand.

## 3. Political climate in international relations

This is a factor which has often exerted an influence on the extent of opening of the Polish economy. At present this factor affects the normalisation of trade and financial relations with the Western countries. Restrictions imposed on Poland intensify the negative influence of a debt barrier upon the functioning of the national economy.

## 4. Trade policy of states participating in international trade

This policy is shaped under a considerable influence of the current situation in the development of the world economy. The slowdown in the rate of international economic growth exerts some pressure to increase protection and discrimination in international trade. The forms of protection applied begin to be dominated by non-tariff barriers which are often imposed one-sidedly<sup>22</sup>. Although Poland has been GATT member since 1967, numerous member states of this organisation, among others the EEC countries, do not fully observe the rule of non-discrimination and Poland is afflicted with e.g. quantitative restrictions on trade imposed by those countries. On the other hand, it may be expected that

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<sup>21</sup> J. Dembowski, op.cit., p. 13.

<sup>22</sup> Compare: M. Paszyński, Polska i GATT (Poland and the GATT), "Handel Zagraniczny", N° 2/1983, p. 8.

Poland will start renegotiating the formula of access to this organisation. The formula of 1967 corresponds neither to the present possibilities in the context of the balance of payments nor to the much more efficient system of economic management introduced in the eighties. The admittance of Poland to the GATT was conditioned by obliging her to increase the yearly imports from the member states by at least 7 percent and from 1970 on the mean annual rate of import growth was to reach 7 percent in three-year periods<sup>23</sup>. Respecting such a formula of access is disadvantageous for Poland mainly because of the necessity to lead a defined export-import strategy of her foreign trade. The formula in question considerably stiffens the import policy, especially in the relations with those countries towards which debt obligations are the greatest. The basis for accepting a different formula of Poland's access to the GATT than the binding formulae for other member states was a different, directive system of business management. Recently this system has been fundamentally transformed and the precedential case of Hungary proved that it is possible to recognise a relatively decentralised managerial system of the socialist economy as the one which fulfills the requirements of the GATT. The renegotiation of the formula should be based on tariff concessions. This is possible because the import tariff introduced in Poland in 1976 is beginning to have a more and more price-creating character. The possibility of granting tariff concessions to foreign partners offered by the new formula of access could mollify the forms of discrimination on the part of those countries by "forcing" a similar procedure and equal treatment. This could increase the accessibility to the markets of those countries as well as the effectiveness of export transactions.

#### 5. Trends in international technological progress

Taking the trends of international technological progress into account in the current process of production and allocation of investments is the condition sine qua non to create a pro-export structure of the national economy and to mollify simultaneously the influence of the balance of payments burden upon its functioning. The economic reform

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<sup>23</sup> H. de Fiumel, Uczestnictwo Polski w GATT w warunkach reformy (Poland's Participation in the GATT Under the Economic Reform), "Handel Zagraniczny", N° 7-8/1984, p. 32.

carried out in Poland takes into consideration the mechanisms which favour innovating the economy. Investing managerial instruments with the nature of economic parameters is connected, among others, with the fact that these instruments have actually assumed the functions of informers on the recommended trends of technological progress. The full exploitation of these functions at the level of microeconomic calculi may encounter barriers in the consciousness of managers who were used to passive forms of management. This exploitation may also encounter barriers connected with the consequences of the inflationary gap on the home market encouraging the production of traditional goods which would sell well on this market.

#### 6. Absolute and relative level of foreign prices

This factor must be considered only in the context of the relation between the import prices and the export prices obtained. For Poland the consequences of the above mentioned relations are important. On the one hand they mollify the impact of debts upon the functioning of the national economy because they favour the realisation of financial obligations. On the other hand, the relations in question weaken the barriers in the internal economic feedbacks thanks to the possible occurrence of the accumulative effect or the increase of consumption imports. At the same time, the very extent of the favourable relation of the terms of trade is important. After a certain level of deficit in turnover has been exceeded, it may go down further even if the relation in question is favourable. To prevent such a situation, one must observe the principle that the relation of exports to imports in a given period should be higher or, at the outmost, equal to the relation of import price increments to export price increments<sup>24</sup>. At the same time this principle may serve as a certain indicator of the limit of safe indebtedness towards foreign partners. It requires, however, very precise methods of forecasting the level of prices in foreign trade.

The extent of Poland's debts is not exceptional in international financial relations. There are countries where the value of absolute debts is

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<sup>24</sup> For details see A. Bień, Planowe wyznaczanie wielkości ujemnego salda bilansu handlowego (Planned Evaluation of the Foreign Trade Deficit), "Handel Zagraniczny", N° 4/1981.

bigger, e.g. Brasil, Mexico, Argentina, South Korea, Venezuela and Israel. Many other countries have their balances of payments burdened with sums totalling many billions of dollars. In 1982 the share of foreign debts which the debtor countries found very difficult to pay off amounted to 20 percent of the total international debt. This share was particularly high in the case of developing countries and reached 70 percent of their joint debts. In the period 1982-1984 the number of countries which had troubles with serving their debts on time increased from 11 to 30<sup>25</sup>.

Debts have become an outstanding problem in global terms. Giving rise to many imminent perils, they adversely affect the functioning of the international financial system and international exchange. Therefore, the solution of this problem should be the concern of both debtors and creditors. Both sides can profit from the normalisation of international economic relations and the possibility to obtain the optimum advantages from their participation in the international division of labour.

In recent years Poland has carried out a series of systematic modifications in the management and functioning of the national economy. If these modifications are systematically and consistently implemented on the basis of the principles of the economic reform and if positive tendencies among the factors of external environment appear, it will be possible to speak about an opportunity of breaking the negative influence of the balance of payments situation upon the functioning of the Polish economy. In this aspect the solution of the debt problem will be a question of time.

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<sup>25</sup> M. Minkiewicz, *op.cit.*, p. 30.