GENERAL AGREEMENT

ON TARIFFS AND TRADE

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Committee on Balance-of-Payments Restrictions

CONSULTATION UNDER ARTICLE XII:4(b) OF THE GATT 1947 WITH THE REPUBLIC OF POLAND

Background paper by the Secretariat

1. This paper has been prepared pursuant to paragraph 7 of the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes.[1]

I. Previous Consultations with Poland

2. Poland has held two consultations in the Committee, following the introduction of a 6 per cent import surcharge under Article XII of the GATT 1947 in December 1992.[2] In its conclusions at its last meeting in June 1994, the Committee noted that since the 1993 consultation Poland's macroeconomic situation had improved significantly; the fiscal deficit had been reduced, inflation was down and Poland was moving towards sustainable growth. However, the external and fiscal balances remained fragile. The Committee expressed disappointment that the surcharge had been maintained and that it had not been reduced to 3 per cent in 1994, and that it would not be eliminated by the end of 1994 as originally planned. It emphasised that, under Article XII of GATT, trade measures were to be used only for balance-of-payments reasons. The Committee noted Poland's commitment to reducing the surcharge to 5 per cent in 1995 and 3 per cent in 1996, and to eliminating it by the end of 1996. Given the improvements in Poland's economic situation and the prospects for faster recovery, the Committee considered that a more rapid phase out could well be possible. The Committee therefore welcomed Poland's readiness to review the situation with it in the spring of 1995.

II. Poland's Trade and Exchange System: Evolution since the last consultation.

(a) Import restrictions

3. Poland deposited the instrument of ratification of the WTO Agreement on 31 May 1995 and would become a full member of the WTO on 1 July 1995. However, the Government decided to "effectively and finally implement, as of 1 January 1995, all tariff reductions scheduled under Section II of Poland's list of concessions and commitments attached to the Marrakesh Protocol. The obligations resulting from Section I of Poland's list of market access commitments are expected to be implemented as of 1 July 1995, to coincide with the implementation date indicated by the European Union in the corresponding part of its own Schedules."[3] By the end of the implementation period of the Uruguay Round tariff commitments, the simple average tariff cut will be 37 per cent for food and agricultural products and 38 per cent for industrial items. The average level of tariff protection after the implementation of the tariff commitments is expected to be 9.9 per cent (trade-weighted), a cut of 38 per cent.

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[1]BISD 26S/205.

[2]BOP/R/206, Corr.1. and BOP/R/216.

[3]WT/L/2.

4. Regarding agricultural products, Poland has bound its tariffs significantly above tariff rates currently applied. The bindings are essentially unrelated to base period conditions due to the specific conditions prevailing in Poland at that time. Poland's bound rates are similar to those of the EU.

5. In 1994, combine harvesters, older than four years have been added to the list of products the imports of which is prohibited. Other items included in this category of goods are: undenatured ethyl alcohol (only until 30 June 1995), passenger motor cars, older than ten years, two stroke engines for automobiles, and trucks, trailers, buses and special vehicles, older than three years. Imports and exports of strong alcohol, natural gas, casein, and some types of cheeses, butter and milk are subject to licensing. Import licences are also demanded for some types of beer, wine and vermouth, while for export of ethyl alcohol, coal, crude oil, petroleum oils, cigarettes, some sauces (CN 2103.90) and flat pallets (CN 4425.2010) licences are required. Imports of alcohol, tobacco, petrol, diesel and heating oil continue to be subject to import quotas. On the export side metal scrap (from group HS 7204) and some types of raw hides and skins are subject to quotas.[4]

(b) The import surcharge

6. In April 1995, Poland notified that the import surcharge had been lowered from 6 per cent to 5 per cent, effective as of 1 January 1995.[5]

(c) Exchange regulations affecting trade

7. On 29 November 1994, Poland lowered the monthly devaluation of the zloty against a basket of five currencies by 0.1 points to 1.4 per cent. On 16 May 1995 a new exchange system was introduced, under which the zloty may float within the limits of +/- 7 percentage points around the central rate, which is devalued by a monthly rate of 1.2 per cent vis-à-vis the basket of currencies.

8. On 31 December 1994, a new foreign exchange legislation entered into force which liberalized payments also in the services sector. Now the freedom to purchase foreign exchange covers all services which have been included in the official classification of services. Polish enterprises, however, still must sell their export earnings to a Polish bank but have the right to buy foreign exchange for current account operations. Enterprises are not authorized to open foreign exchange accounts. In May 1995, as of 1 June 1995, Poland formally accepted the obligations of VIII, Sections 2,3 and 4 of the Fund's Articles of Agreement.

9. At the beginning of 1995, Poland introduced the new zloty which is equivalent to 10,000 old zlotys.

III. Macroeconomic and Trade Developments

Introduction

10. Poland embarked on a wide-ranging reform programme in 1990, aimed at containing strong inflationary pressures and making the transition to a market economy. The financial policy component of the programme included a commitment to sharply reduce the fiscal deficit, to introduce a temporary fixed exchange rate as a nominal anchor to break the emerging hyper-inflationary tendencies, and a

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[4]GATT NTM/W/6/Rev.5/Add.7.

[5]L/7461 Add.1.

tax based incomes-policy to restrain wage claims. The programme was initially associated with a sharp decline in output, and Poland entered a severe depression. Since 1992, however, the Polish economy has been showing signs of a strong recovery, and of a successful transition to a growing market economy.

11. The initial force behind the recovery in 1992-93 was the growth of domestic consumption but the pattern began to change in 1993 when domestic investments sharply increased. The growth of investments continued in 1994, and the growth of output was further fuelled by the strength of exports. The switch in the structure of spending has considerably eased the balance of payments pressures. A sharp slowdown in the growth of domestic consumption combined with the growth of national income have resulted in an increase of national savings, and this has facilitated the financing of domestic investments. Moreover, the acceleration of exports and a slowdown in the growth of imports sharply reduced the current account deficit in 1994 and thus the need for foreign savings to finance domestic investments. At the same time, Poland experienced a large increase in the inflow of short-term capital, and this has led to a large increase in the level of international reserves.[6] Moreover, following the debt rescheduling agreement with the London Club, Paris Club and with Russia, the total outstanding debt of Poland has been reduced and restructured.

Output, prices and employment

12. The recovery of production started in 1992 and has been accelerating over the last two years. Following the growth of 3.8 per cent in 1993, GDP growth in 1994 has been estimated by the IMF to be 6 per cent. Even though the preliminary official government figures suggest that the growth was about a percentage point lower, it is beyond doubt that the Poland registered one of the most dynamic growth rates in the whole Europe (Chart A). The growth originated in 1994 in a strong performance of the industrial sector. Industrial sales increased by 11.9 per cent which compares with the growth of 6.2 per cent in 1993 and 3.9 percent in 1992. The fast growth of industrial output has been partly due to the rapid growth of the emerging private sector. Sales of the private industry expanded by 22.7 per cent in 1994, another year of rapid growth after two booming years in 1992 and 1993 when sales increased by 23.4 per cent and 34.7 per cent respectively. The private sector share in the total industrial output is currently about 40 percent. Public sector sales increased as well - by 5.8 per cent. The sales of the processing industry increased by 13.3 per cent and those of the mining industry by 6.2 per cent. The other fast performing sector has been the service sector, including, in particular the trade and financial sectors. On the other hand, construction output stagnated in 1994 (0.2 percent) and agricultural output is estimated for the same year to be 8 per cent below the level of 1993.

13. Inflation stabilized in 1994 just below the rate of 1993 (See Chart B). The inflation rate (defined as the change in consumer prices) is estimated to have reached in 1994 the level of 32.2 per cent measured as an average for the whole year. After the considerable success in reducing the rate of inflation in 1991 and, again, in 1992, the authorities found it more difficult in 1994 to push the inflation significantly below the 1993 level.

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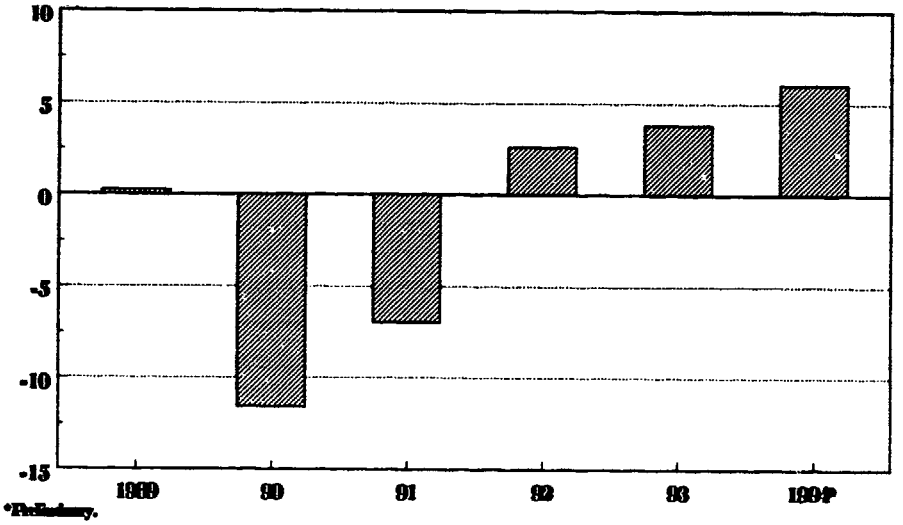
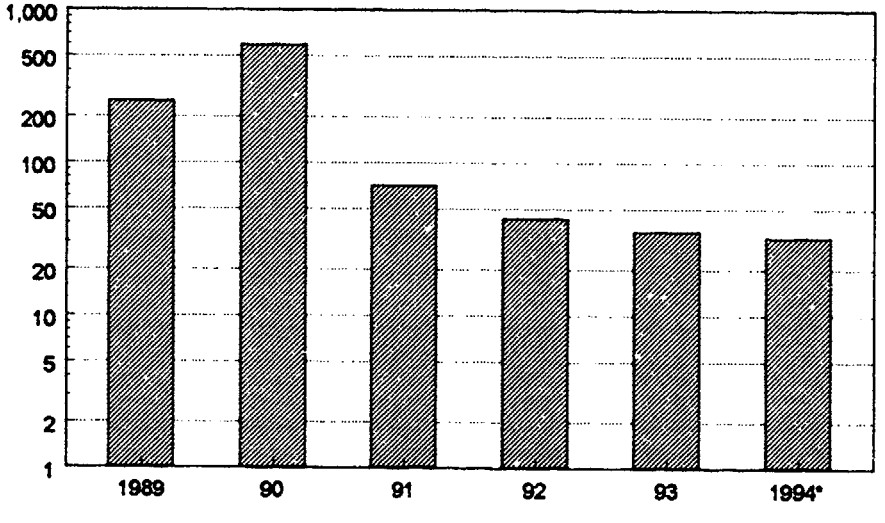
[6]Poland's balance of payments is derived from a payments basis, and a large component of short-term capital consists of purchases of foreign exchange from kantors (foreign exchange bureaus). The original source of the foreign exchange came from border trade.

Chart A - Poland - Growth of real GDP, 1989-94
(Annual percentage change)



*Preliminary.
Source: IMF

Chart B - Poland - Consumer prices, 1989-94
(Annual percentage change)



*Preliminary.
Note: Data in this chart refer to consumer prices measured in terms of period average. This chart is in semi-logarithmic scale.
Source: IMF

14. The growth of domestic output has been conducive to a small improvement in the labour market. The economic recession in the 1990's brought along a sharp reduction in demand for labour resulting in a reduction of employment and in an increase of unemployment. Total employment declined from 17.1 million in 1989 to 14.6 million in 1994, or by 2.5 million which corresponds to a fall of 14.6 per cent. Most affected were the manufacturing, agricultural and construction sectors which accounted for the bulk of the decline. Employment increased in only three sectors - the financial services, state administration and, in particular, trade which employed extra 640 000 persons in 1994 in comparison to 1990. The number of unemployed was rising until 1993 when the total number of persons without work reached 2 890 000 and the unemployment rate was 16.4 per cent. The acceleration of economic growth in 1994 put a stop to the growth of unemployment. The total number of persons without work declined for the first time since 1989 (by about 50 000), and the unemployment rate declined to about 16.0 per cent. Nevertheless, the total employment continued to fall even in 1994. According to the preliminary official figures, total employment reached the level of about 14.3 million, which corresponds to a decline of about 2 per cent.

Balance of Payments

15. Poland's balance of payments position has been for some time dominated by two developments - the changes in the trade account and a heavy debt burden, mostly contracted before the reform period, and requiring difficult negotiations with official and commercial creditors. The official foreign debt was successfully renegotiated in March 1991while the commercial debt was rescheduled in 1994. In addition, Poland has successfully concluded its negotiations with the former CMEA countries and with Russia.The unresolved issues of external debt were particularly damaging in the early 1990's. They acted as a deterrent to potential foreign investors and, as a result, the foreign capital inflows into Poland were until recently very limited. The small volume of capital inflows weakened the balance of payments and imposed a constraint on the level of the current account deficits that Poland was able to run. This, in turn, restricted the policy options of the authorities in encouraging domestic growth. Until 1994, when capital inflows dramatically increased, the management of the current account position called for considerable government interventions to contain the growth of the current account deficit.

16. Government interventions were, broadly speaking, conducted on two levels - by taking measures affecting the competitiveness of the Polish economy and macroeconomic measures leading to significant adjustments in the fundamental macroeconomic balances between savings and investments. The following section describes the evolution in the balance of payments account in 1994, and the main issues of adjustment and the main policy instruments are discussed in the subsequent section. The latter only covers the areas of monetary, fiscal and exchange rate policies. Other measures, notably structural policies such as privatization, financial sector reform and reform of the social security system have also been on the agenda of the government polices but they are not covered in this document.

Current account

17. As discussed in last year's report of the Secretariat to the committee, Poland has had a current account deficit since the early 1980's with the exception of one year - 1990. These deficits have been primarily determined by two factors - the changes in the trade account and the changes in interest payments on Poland's external debt. The trade balance has been, in turn, affected by three major developments -the process of domestic adjustments following the introduction of market reforms, which initially led to a deep domestic recession in 1990 and 1991 but was followed by the subsequent recovery noted above; the other two main developments were the collapse of the former CMEA market and the Western recession, both of which adversely affected the Poland's trade performance. The amount of interest payments was partly dependent on the level of interest rates. Nevertheless, the size of the external debt was large and Poland had difficulties making regular service payments until its final

agreement with commercial creditors in 1994. As a result, the country accumulated a substantial amount of arrears on its obligations that year.

18. Relative to 1993, the current account performance was fundamentally improved in 1994. The current account deficit was reduced from US$2.3 billion in 1993 to US$1.1 billion in 1994, or a reduction of more than 52 per cent. This was brought about mainly by the large improvement in the trade balance and a 33 per cent increase in foreign transfers to Poland (Table 1). Actual interest payments increased from US$ 0.8 billion in 1993 to about US$1.1 billion in 1994. The interest payments due, however, were US$ 1.9 billion, and this means that Poland has maintained some arrears on interest payments but, according to the present schedule, they will be settled in 1995.

Table 1 - Poland - Selected Indicators of Balance of Payments, 1991-94
(In millions of U.S. dollars)

	1991	1992	1993	Estimate 1994
Trade balance	51	512	-2,293	-836
Exports	12,760	13,997	13,585	16,950
Imports	12,709	13,485	15,878	17,786
Interest (net)	-2,862	-1,740	-1,392	-1,629
Receipts	541	527	400	275
Payments due	3,403	2,267	1,792	1,904
of which: paid	885	1,097	827	1,110
Transfers (net)	353	528	929	1,182
Current account balance	**-2,222**	**-270**	**-2,287**	**-1,079**
Capital account	**-7,954**	**373**	**1,524**	**2,677**
Medium- and long-term capital (net)	-6,059	-292	-471	31
Disbursements	786	562	922	894
Amortization due	6,845	854	1,393	863
of which: paid	347	443	903	503
Direct investment	117	284	580	542
Short term capital	-1,254	598	1,095	3,791
Net international reserves (-, increase)	1,317	-1,614	-634	-2,534
Debt relief[1]	4,382	202	...	7,900
Change in arrears[1]	4,477	1,309	1,397	-6,965
Memorandum items				
Current account in percent of GDP	-2.9	-0.3	-2.7	-1.1
Import volumes (percent change)	...	4.1	24.1	7.1
Export volumes (percent change)	...	5.9	4.4	20.7
Terms of trade	...	1.7	-2.0	-1.1
Gross official reserves (months of import of goods and nonfactor services)	3.3	3.5	3.0	3.6
Total debt as percent of GDP (including Fund)	61.9	57.5	56.6	43.3
Debt service/export of goods and nonfactor service (including Fund)	71.5	20.0	21.5	16.2

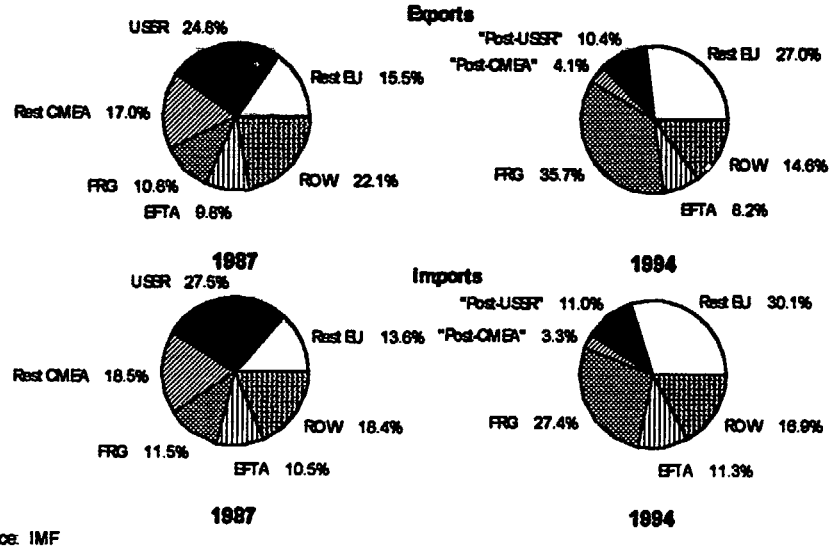
[1]Includes also a debt rescheduling agreement with Russia.

Source: IMF

19. The improvement in the trade balance in 1994 reflected two significant changes. The expansion of imports slowed in comparison to the previous year in spite of stronger growth of domestic output and aggregate demand. The increase in import volumes was only slightly above the rate of growth of GDP. At the same time, exports increased by 20.7 per cent in real terms, largely benefitting from the European recovery and a recovery of trade with the former USSR and the countries of Central and Eastern Europe. This improvement in export performance in 1994 has produced by far the best export performance since the introduction of economic reform in 1989, and the export growth has significantly contributed to the domestic recovery. The improvement in the trade balance was all the more significant in the light of the unfavourable changes in terms of trade, which deteriorated by an estimated 1.1 per cent.

20. The sharp acceleration in the growth of exports and the considerable slowdown in the growth of imports in 1994 have been the result of a trade adjustment process that was prompted by the collapse of CMEA and the introduction of market reforms. As discussed in last year's Secretariat's report, the geographical structure of Poland's trade has been changing radically since the late 1980's. While in 1987, 42 per cent of Poland's exports went to the former CMEA countries (Chart C), the corresponding share in 1993 dropped to 13.5 per cent. The trend was stopped in 1994. According to the official sources, exports to the former CMEA increased by 33.7 per cent compared to 1993 while those to the European Union grew relatively more slowly - but by a still highly respectable rate of 20.9 per cent. The share of the former CMEA in total exports of Poland currently stands at 14.5 per cent while that of the European Union is 62.7 per cent (Chart C). Similar trends can be observed in the case of imports. The share of imports from the CMEA countries declined from 46 per cent in 1987 to 11.4 per cent in 1993 while the share of imports from the European Union more than doubled from 25 percent to over 57.2 per cent in 1993. Once again, these trends did not continue in 1994 as imports from the former CMEA countries increased by 16.6 per cent while imports from the European Union increased by 15 per cent in comparison to 1993. The share of the CMEA countries in Poland's imports increased to 14.3 per cent while the share of the European Union remained basically unchanged at 57.4 per cent.

Chart C - Poland - Distribution of trade by main regions, 1987and 1994 (In percentage)



Source: IMF

Note: In 1994, "Post-USSR" corresponds to the territory of the former USSR and "Post-CMEA" corresponds to the countries of the former CMEA, excluding the former USSR. ROW stands for Rest of the World.

21. In contrast, the adjustment in the commodity structure has been considerably less pronounced than the adjustment in the geographical structure. The export structure has been shifting towards higher share of manufactured goods while the share of energy and raw materials as well as that of agriculture have been declining (Table 2). This reflected mainly the effect of the collapse of the CMEA market which had provided strong incentives to exporters of natural - resource intensive products. Within manufacturing, there has been a shift towards machinery and transport equipment, reflecting a shift of supplies from the former CMEA market to the OECD market, mainly to the European Union. The other major beneficiary of the shift to the European market has been the textile industry which has expanded its exports thanks to sub-contracting arrangements with West European suppliers. Other traditional exports such as base metals have been relatively contracting. The import structure has been affected by similar forces (Table 3). The sub-contracting arrangements with Western suppliers have been greatly responsible for the expansion in the share of textiles in total imports. The dramatic reductions in production of energy-related products and raw materials in the former Soviet Union together with the fall of domestic output and with energy-saving measures adopted internally have led to a large drop in the volume of imports of energy products and raw materials as well as in the share of these commodities in total imports from that region.

Table 2 - Poland: Commodity composition of merchandise exports, 1991-1994
(Percentage shares)

	Shares		Absolute difference
	1991	1994	1991-94
Animal products	7.3	3.6	-3.7
Vegetable products	6.0	3.2	-2.8
Fats and oils	0.3	0.1	-0.2
Prepared foodstuffs	4.3	5.2	0.9
Mineral products	15.0	11.2	-3.8
Chemical products	8.9	6.0	-2.9
Plastics	2.2	2.5	0.3
Leather products	1.1	0.8	-0.3
Wood products	4.4	4.5	0.1
Wood pulp products	1.0	1.6	0.6
Textile products	4.4	13.1	8.7
Footwear	0.9	1.2	0.3
Stone products	2.9	1.9	-1.0
Precious materials	1.0	1.1	0.1
Base metal products	19.0	16.8	-2.2
Mechanical and electrical machinery	9.4	10.1	0.7
Transport equipment	5.2	10.1	4.9
Optical products	1.0	0.7	-0.3
Arms	0.2	0.2	0
Miscellaneous manufactured products	3.2	6.1	2.9
Art	2.2	0	-2.0

Note: The sums may not add up to 100 due to rounding.

Source: Official data.

Table 3 - Poland: Commodity composition of merchandise imports, 1991-1994
(Percentage shares)

	Shares		Absolute difference
	1991	1994	1991-94
Animal products	2.6	2.4	-0.2
Vegetable products	3.8	3.5	-0.3
Fats and oils	0.6	0.8	0.2
Prepared foodstuffs	6.8	4.4	-2.2
Mineral products	21.4	12.3	-9.1
Chemical products	8.3	11.8	3.5
Plastics	3.4	6.2	2.8
Leather products	0.4	0.9	0.5
Wood products	0.2	0.4	0.2
Wood pulp products	2.5	4.1	1.6
Textile products	6.0	10.4	4.4
Footwear	0.9	0.7	-0.2
Stone products	1.5	1.8	0.3
Precious materials	0.1	0.1	0
Base metal products	4.2	6.3	2.1
Mechanical and electrical machinery	24.6	23.6	-1.0
Transport equipment	7.8	5.1	-2.7
Optical products	2.7	2.7	0
Arms	1.8	0	-1.8
Miscellaneous manufactured products	0	1.9	1.9
Art	0.2	0	-0.2

Note: Sums may not add up to 100 due to rounding.

Source: Official data.

Capital Account

22. The capital account has been historically dominated by one single item - external debt - which, in turn, influenced foreign investments and borrowing in Poland and large outflows of capital for debt amortization and forced the government to maintain some restrictions on the outflow of foreign currency. The post-reform governments of Poland inherited a heavy burden of external debt from the previous regime, which reached the level of almost US$ 49 billion in 1990, or about 62 per cent of GDP (Table 4). The debt to Paris Club represented about 61 per cent of this amount while the commercial debt was about 26 per cent. The debt service ratio - debt service payments as the percentage of earnings from exports of goods and services - reached a high level of 71 per cent in 1991. The burden of debt was well above the country's servicing capacity, and various Polish governments have been involved in a series of debt rescheduling negotiations. The first important breakthrough came in March 1991 when the government reached an agreement with the Paris Club. The agreement provided for debt and debt service reductions on conditions that were exceptional for a middle-income country. The negotiations with commercial creditors turned out to be more difficult. Poland had a long history of 14 years negotiating with these creditors but a final agreement was not reached until 1994. The agreement, which covered virtually all commercial creditors under the umbrella of the London Club, provided for a reduction of the commercial debt and for a restructuring of the debt through long-term bond issues.

Table 4 - Poland - Gross External Debt, 1989-1994

	1989	1990	1991	1992	1993	Estimate 1994
Gross External debt (end of period)[1]						
- In billions of U.S. dollars	40.2	48.9	48.3	48.2	48.7	40.9
- Ratio to exports of goods and nonfactor services in convertible currency	4.8	4.0	3.3	3.1	5.2	2.1
Memorandum items:						
Total debt as percent of GDP[1]	...	...	61.9	57.5	56.6	43.3
External debt service ratio[2]						
- Due	61.6	56.3	71.5	20.0	21.5	16.2
- Paid	19.0	6.9	8.6	9.9	12.1	10.1

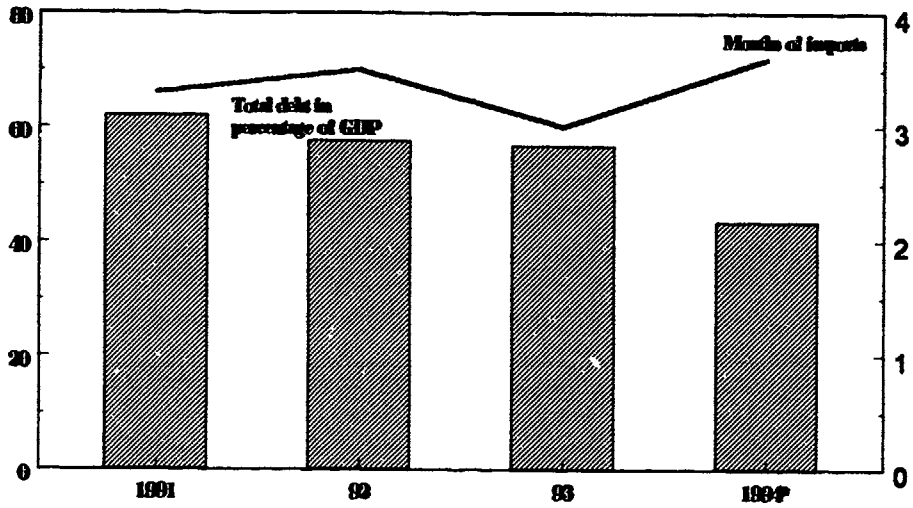
Note: [1]Including arrears and the Fund.
[2]In percent of exports of goods and nonfactor services in convertible currencies, including theFund.

Source: IMF.

23. The successful conclusion of the negotiations with the London Club has had a major impact on the capital account. Prior to the agreement the main capital inflows came from official sources, mainly from the World Bank and the IMF, but also from the European Investment Bank and the European Bank for Reconstruction and Development. The other sources of medium- and long- term credit were the suppliers' credits or commercial banks' credits of short maturity. The access to medium- and long-term commercial credit was virtually cut off. Similarly, foreign direct investments were relatively small, particularly given the large size of the economy and much greater amount of foreign investments flowing into the neighbouring countries - the Czech Republic and especially Hungary. The main impediment for a better access to foreign borrowing and foreign investments was the heavy debt burden noted above and the inability to service the debt. As a result, the country accumulated large arrears on its debt obligations which in one year alone -1991- increased by US$ 4.5 billion.

24. The normalization of relations with its creditors combined with the strong growth of the external sector and of domestic output have increased significantly the country's access to the international capital markets. Even though foreign direct investments remained in 1994 at about the same level as in the previous year, the volume of the short-term capital inflows almost quadrupled the same year reaching the level of US$ 3.7 billion. This, together with the significant reduction of trade deficit, the increase in net transfers and the reduction in the debt amortization following the debt agreement have been the main reasons for a large - US$ 2.5 billion - increase in the level of international reserves which stood at the end of 1994 at 3.6 months of imports (Chart D).

Chart D - Poland - Total debt and gross official reserves, 1991-94 (In percentage of GDP and months of imports)



Note: Left-hand scale refers to total debt; right-hand scale refers to months of imports.
* Estimates.
Source: IMF.

Macroeconomic adjustment

Savings - Investment Balances

25. In view of the limited access to foreign borrowing, the current account deficits had to be constrained primarily by domestic macroeconomic adjustments. Poland - like other countries in transition in the region - traditionally had a relatively high rate of domestic investments in GDP. In contrast to some, although not all, countries in transition, however, a part of the financing of these investments - the excess of domestic investments over national savings which is by definition the current account deficit - had to come partly from foreign sources in the form of foreign savings. This excess of domestic investment over national savings has been frequently changing. Foreign savings and their equivalent - current account deficit - represented up to 3 per cent of GDP in one year since 1989 and financed up to 15 per cent of domestic investments. A shortfall in foreign exchange due to a deteriorating current account position or due to smaller inflows of foreign capital would normally require an adjustment

in the national savings rate - in particular, of the government - or other measures to reduce domestic investment.

Table 5 - Poland: Savings - Investment Balance, 1991-94
(In percent of nominal GDP)

	1991	1992	1993	1994
Foreign Savings (capital inflow)	2.6	-1.1	0.6	-2.3
Current account deficit	2.9	0.3	2.7	1.1
Unrecorded trade	-0.4	-1.4	-2.0	-3.4
Gross National Savings	17.3	16.3	14.9	17.6
Government	-4.0	-4.7	-1.1	-0.9
Nongovernment	21.3	21.0	16.0	18.5
Gross Domestic Investments	19.9	15.2	15.6	15.3
Government	5.6	3.7	3.4	3.1
Nongovernment	14.3	11.4	12.2	12.2

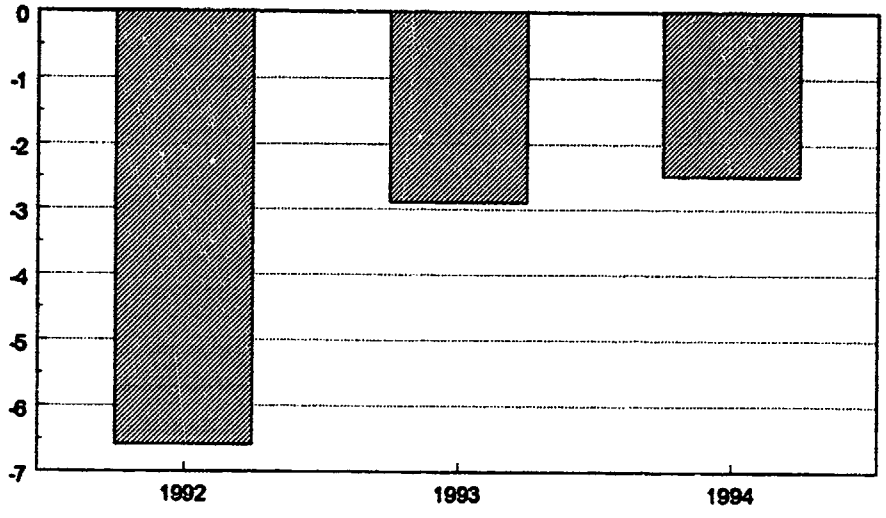
Notes: External current account deficit is indicated with a positive sign. Government savings are calculated as the residual between current revenues and current expenditures (including interest payments). The nongovernment sector was obtained as the residual. The current account deficit was measured on an accrual basis, i.e. external interest payments are on a commitment basis.

Source: IMF

26. The actual macroeconomic adjustments since 1990 have included changes both in the rate of domestic investment and in the rate of national savings (Table 5). National savings have traditionally come in Poland from the non-government sector - from households and firms - while the government has been dissaving. It is estimated that the rate of national savings declined by about 3.8 percentage points between 1990 and 1993. The decline reflected a significant fall in the savings rate in the private (non-government) sector while the government's dissavings were also reduced. The decline in the savings rate combined with the severe constraint imposed by limits on external borrowing resulted in a substantial reduction in the domestic investment rate - both in the government and non-government sectors. In contrast to the early 1990's when the investment rate stood at almost 22 per cent of GDP, the rate fell by 1993 to about 15.6 per cent.

27. The adjustment pattern was changed fundamentally in one respect in 1994. Gross domestic investment as a percentage in GDP continued to fall but the share of national savings in GDP was significantly increased. The growth of national savings was due to a further reduction in the government dissavings, which has led to a further reduction of fiscal deficit as a percentage in GDP (Chart E), and a substantial increase in non-government savings. The reduction of domestic investment as a share in GDP affected both the government and the non-government sectors.

Chart E - Poland - Central government balance, 1992-94 (Percentage of GDP)



Source: IMF

Public Finance

28. The reduction in the government dissavings came mainly from the significantly improved revenue performance while government expenditures have remained relatively stable as a percentage of GDP (Table 6). The improved resource mobilization by the government was due to fiscal and tax reforms which have shifted the tax effort towards the household sector, while corporate taxation has declined in relative terms. The increased revenues have, therefore, reflected mainly increased revenues from personal income taxes and from indirect taxes, a process that started in 1993 and continued in 1994. Privatization receipts have increased but still represent a relatively small percentage of total government revenues (2.5 per cent in 1994). A more efficient collection of customs duties and, in particular, the introduction of import surcharges in December 1992 have also contributed to the improved revenue performance. The total revenues from these two import measures reached almost the level of revenues from corporate taxes. On the expenditure side, the main measures included the restraint of capital spending noted above and the elimination of many subsidies. However, the government spending on social security and for debt service almost tripled in both cases. The increase in transfers to social security has been particularly dramatic as a result of high unemployment and the generous system of social entitlements. In sum, the government has made major strides in reducing the fiscal deficit, which represented almost 7 per cent of GDP in 1992 but declined to 2.5 per cent of GDP in 1994.

Table 6 - Poland - State Budget Aggregates, 1992-94

	1992	1993	Estimate 1994
		(In billions of zlotys)	
State budget revenue	30.9	45.9	63.1
of which:			
Personal income tax	7.2	12.0	17.4
Turnover/VAT, excises	10.3	17.0	24.3
Customs duties	2.7	3.4	4.9
Import surcharge	...	1.7	2.6
Privatization receipts	0.5	0.8	1.6
State budget expenditure (cash basis)	38.2	50.3	68.9
of which:			
Transfers to social security funds	9.0	12.4	17.1
Subsidies	3.9	3.6	...
Capital expenditure and net lending	2.4	3.1	3.4
Interest expenditure[1]	3.1	5.3	8.7
		In per cent of GDP	
Memorandum Items			
State budget revenue	26.8	29.5	29.4
of which:			
Personal income tax	6.2	7.7	8.1
Turnover/VAT,excises	8.9	10.9	11.3
Customs duties	2.3	2.2	2.3
Import surcharge	-	1.1	1.2
Privatization receipts	0.4	0.5	0.7
State budget expenditure [2]	33.7	32.8	32.4
of which:			
Transfers to social security funds	7.8	8.0	8.0
Subsidies	3.4	2.3	-
Capital expenditures and net lending	2.1	2.0	1.6
Interest expenditures	2.7	3.4	4.1
General government balance	-6.6	-2.9	-2.5

Note:

1 Does not include payments for invoked guarantees.
2 Includes the financing of the DDSR operation with commercial creditors estimated to have cost the budget ZL 3.1 billion.

Source: IMF

Money and credit

29. The second important area of policy measures to stimulate domestic adjustment was monetary and credit polices. The authorities have made a considerable effort to restrain the growth of monetary expansion which in the past fuelled a high rate of inflation. The success in controlling inflation is crucial to support the domestic adjustment process since both savings and investment are highly sensitive to the rate of inflation. The recent monetary policy built on the success of the stabilization programme introduced in 1992. The main target of the programme has been the curtailment of credit to the government which had a strong demand for deficit financing to fund its fiscal deficits. Since the bulk of the deficit financing has traditionally been provided by the central bank, the credit to the government

tended to be highly inflationary. The first major steps were taken in 1992 and in 1993 and the policy continued in 1994. As a result, the central bank succeeded in slowing down the annual growth or broad money from about 58 per cent in 1992 to 36 per cent in 1993 and the growth was held to about the same rate in 1994. The extent of the credit restraint can be seen from the growth of total credit after allowing for the effect of inflation. The real growth of credit declined in 1993 by 3.0 per cent in 1993 and by additional 3.3 per cent in 1994. The credit restraint affected primarily the non-government sector, while the real net credit to government continued to grow albeit at reduced rates.

30. The success in reducing the rate of inflation has also been beneficial in terms of public willing to hold domestic money. The demand for money has been growing, which was reflected at first in faster growth of foreign currency deposits in 1993 and later in further growth of both foreign currency and zloty deposits. The ratio of foreign currency deposits to broad money, which increased from 24.8 per cent in 1992 to 28.8 per cent in 1993 sightly declined in 1994 to 28.5 per cent. In sum, the financial performance was - relative to the targets of the government stabilization programme - comfortably on track.

Exchange Rate

31. The third important policy measure to encourage domestic adjustment has been the exchange rate policy. The successive Polish governments have applied two basic approaches to exchange rate management. Initially, starting in 1990-1991, the government substantially devalued the currency and introduced a new mechanism based on the fixed exchange rate. The policy was retained until October 1991 when the Government switched to the policy of a crawling peg which aimed at maintaining the exchange rate competitive at a certain level by keeping the real effective exchange rate stable. This policy continued in 1994 and, in view of the more rapid inflation than in the competitors' countries, the exchange rate was again devalued by about 15 per cent in comparison to 1993. The current policy continues to have the competitiveness of the Polish industry as its main objective. Nevertheless, a new feature of the policy is the recent introduction of a trading band for the currency amounting to 14 per cent to allow for a more flexible adjustment of the exchange rate in the light of changing capital movements.