

Committee on Balance-of-Payments Restrictions

REPORT ON THE CONSULTATION UNDER ARTICLE XII:4(a)
WITH THE REPUBLIC OF POLAND

1. The Committee consulted with Poland on 31 March and 2 April 1993, in accordance with its terms of reference, pursuant to Article XII:4(a) of the General Agreement and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD26S/205). The consultation was held under the chairmanship of Mr. P. Witt (Germany). The International Monetary Fund was invited to participate in the consultation in accordance with Article XV:2 of the General Agreement.

2. The Committee had the following documents before it:

Initial full report by the Government of Poland for its
Trade Policy Review (to be considered as the basic document) C/RM/G/31

Notification by Poland L/7164

Background paper by the Secretariat BOP/W/150

International Monetary Fund, Statistical Supplement, dated
14 July 1992 and Supplementary Background Material for
the GATT, dated 17 March 1993.

Opening Statement by the representative of Poland

3. The opening statement of the representative of Poland is attached as Annex I.

Statement by the representative of the International Monetary Fund

4. The statement made by the representative of the International Monetary Fund is attached as Annex II.

(i) Balance-of-payments position and prospects: alternative measures to restore equilibrium

5. Members of the Committee welcomed Poland's commitment to continue its radical economic reform programme, undertaken since the beginning of 1990. Economic transition had been accompanied by domestic recession, exacerbated by a 1992 drought, which could affect economic performance over a three-year period. However, following two years of significant declines in real GDP, the Polish economy appeared to have expanded in 1992.

crawling peg, reflecting differentials in the rates of inflation between Poland and its major trading partners. The Polish authorities pursued fiscal restraint to control domestic inflation.

7. Members understood that Poland's fiscal balance was precarious and could deteriorate further. Details were requested concerning the size and composition of Polish public debt and the effects of debt servicing obligations. Recognizing the fiscal impact of the import surcharge, members requested details concerning studies of expected government revenue from the surcharge, and as well as its effects on inflation and trade.

8. Several members stressed that structural measures were essential in addressing Poland's economic problems, notably increasing efficiency in State enterprises and continued progress in privatization. Action should concentrate on measures which would expand rather than contract trade. Concerns were expressed that the import surcharge represented a possible backtracking on previous trade liberalization. Two members referred to data indicating an improved trade balance and a rise in Polish foreign exchange reserves in 1992. While not questioning the importance of structural measures in the longer term, one member was surprised, however, that some participants could consider privatization as a viable alternative to a surcharge in response to an imminent threat to the balance of payments.

(ii) System, methods and effects of import restrictions

9. Members welcomed the substantial trade liberalization in Poland in recent years. Moving from a quantity-based import system, tariffs had become the major trade policy instrument. While the GATT consistency of the import surcharge was not questioned, several members expressed concern that Poland might not be able to maintain its schedule of reducing the surcharge to 3 per cent in 1994. The measure should be terminated before the end of 1994 should economic conditions improve. Questions were asked concerning the product coverage of the surcharge and whether it was applied on a duty-inclusive basis for imported products.

10. One member observed that Poland had currently no bound tariffs in the GATT and asked about Poland's intentions in this area.

11. One member requested an explanation for Poland maintaining import licences, noting that the requirements applied to a limited number of goods. Poland apparently levied a turnover tax at varying rates and was asked what implications current rates would have for the imposition of value added tax, replacing turnover taxes in July 1993. The Polish representative was also asked whether turnover tax was imposed on a duty-inclusive basis.

12. One member noted the possibility of a significant increase in excise taxes during 1993. Tax rates apparently differentiated between imports and locally produced items concerning alcoholic beverages, fuels, and automobiles.

13. One member asked for further details concerning the present status of former foreign trade organizations, seen against the background of privatization programmes and measures to increase efficiency in State enterprises.

14. In reply to questions raised under (i) and (ii), the representative of Poland underlined his country's commitment to free trade and maintaining an open economy. Poland considered the introduction of a temporary import surcharge, rather than quantitative measures, to be the most

appropriate and least distorting manner to address the rapid deterioration in its foreign exchange position. Devaluation of the zloty was not considered a viable option, primarily because of its inflationary impact. Reliable estimates of the impact of the surcharge on Poland's trade and balance of payments were not available.

15. Poland's foreign trade had been in balance until September 1992. Subsequently, import growth had not been matched by rising exports. The trade deficit had continued in early 1993, causing concern about the outlook for the current account.

16. Pending legislation on value added taxation would confirm the elimination of the surcharge at the end of 1994. The foreign exchange position at the end of 1993 would determine the rate to be applied in 1994. The GATT notification would be updated if necessary. The surcharge was applied in a non-discriminatory manner. The surcharge was expected to result in a 1 per cent increase in consumer prices in 1993.

17. The Polish Government had taken a number of measures to reduce the fiscal deficit, including reductions in real expenditure and increased taxation. The direct fiscal impact of the import surcharge amounted to nearly 1 per cent of GDP. Indirect effects were difficult to estimate. A manageable public debt was a prerequisite for controlling inflation.

18. Poland was determined to proceed with its mass privatization programme. Most of the former foreign trade organizations were in the final stage of privatization. Legislation granted any person the right to engage in foreign trade and more than 100,000 units were involved in this activity.

19. Effective 5 July 1993, a value added tax, levied at rates of 7 or 22 per cent, would replace existing turnover taxes. The present system was complicated. Imported items were taxed at the duty-inclusive value. Excise taxation treated imported and locally-produced goods equally. The Polish currency was depreciated in accordance with a preannounced crawling peg. Customs officials used Monday rates for customs valuation purposes.

20. Import licensing procedures were in conformity with GATT rules. Licenses were issued in specific cases to administer tariff quotas, to permit orderly conduct of business transactions, to permit Customs to collect taxes for the Treasury, and to protect public health. Administrative measures were not employed to mitigate the balance-of-payments situation. Any import measure should be in conformity with the GATT. Poland had been reluctant to use safeguard procedures, including provisions existing in its free trade agreements.

21. Poland had received requests to bind tariffs during the renegotiation of its Protocol of Accession. An offer covering agricultural and industrial goods would be submitted in the Uruguay Round.

22. The exact size of the 1992 trade deficit could not be confirmed until the release of final figures in May. Discrepancies in trade statistics derived from customs or payments data occurred in many countries and could be due to differences in reporting practices.

23. One member asked for further clarification of the import licensing régime. The representative of Poland said that a written reply to this question would be circulated to all members of the Committee.

(iii) Conclusions

24. The Committee commended Poland for the significant progress achieved in the transition to a market-based trade and economic system since the introduction of its comprehensive, radical reform programme. The Committee welcomed the major liberalization of Poland's trade and payments system undertaken as part of these reforms. It was noted with satisfaction that, after two years of sharp decline, Poland had seen a turnaround in economic activity in 1992.

25. The Committee noted the difficulties encountered by Poland in its transition to a market economy, which included a substantial fiscal imbalance. As a result of an expected slowdown in export growth and an increase in imports, in part due to the negative impact of the 1992 drought, the external outlook had become more fragile.

26. In the absence of policy action, this, in addition to envisaged debt servicing payments, would have created adverse pressures on Poland's official reserves. The Committee understood that the economic programme adopted by Poland sought to remedy the fiscal imbalance, permit the stabilization of its reserve position and preserve momentum towards further progress in structural adjustment. However, some concerns were expressed that there might be some backsliding in Poland's trade liberalization process.

27. The Committee understood that the import surcharge of 6 per cent was introduced by Poland as a temporary measure, in view of a perceived imminent threat of further deterioration in the balance-of-payments situation linked to the drought conditions experienced in 1992, as well as in a situation of fiscal imbalance. The Committee welcomed the fact that the measure was transparent and price based; that its coverage would extend to all imports; that it was implemented in a non-discriminatory manner; and welcomed the firm intention of the Polish authorities to eliminate the surcharge by the end of 1994 .

28. The Committee recognized that the surcharge was applied in a manner consistent with Article XII of the GATT and the provisions of the 1979 Declaration. However, it encouraged Poland to pursue its reform programme through economic measures which expand, rather than contract, international trade. The Committee therefore urged Poland to hold to the original timetable for reduction of the surcharge to 3 per cent, as indicated in its notification of 30 December, 1992 and looked forward to the elimination of the surcharge by the end of 1994, or even earlier if circumstances permit.

Annex IOpening statement by the delegation of Poland
(consultation under article XII:4(a))

Pursuant to consultation provisions of Article XII:4 of the General Agreement, the Government of Poland wishes to present its case to members of this Committee and, through them, to other GATT contracting parties. The matter which we raise relates to a temporary import surcharge applied by Poland since 17 December 1992 until the end of 1994 in order to assist in remedying the balance-of-payments situation. The surcharge has been notified by Poland promptly, less than two weeks after it had become effective, as required by Article XII:4(a). The notification is contained in GATT document L/7164.

In my opening statement to you I intend to provide additional information concerning the BOP-related circumstances of the surcharge, and the modalities of this measure as seen against the backdrop of Article XII disciplines.

May I also note that these consultations are held less than three months after a thorough trade police review of Poland was conducted by the GATT Council on the basis of up-to-date information. Furthermore, some additional background records have been provided for the benefit of this meeting by the Secretariat and by the International Monetary Fund. Therefore I may hopefully feel free to refrain from making extensive references to the general economic conditions and reform policies of Poland, although they are directly linked to the issue at hand.

Essential features of the surcharge

The surcharge was established by a Decree of the Minister of Finance, dated 18 November 1992, and published in Dziennik Ustaw (Journal of Laws) No. 86, Item 437, of 26 November 1992.

May I recall that the surcharge amounts presently to 6 per cent of the customs value of imported goods, as defined by Articles 1 and 8 of the Agreement on Implementation of Article VII.

Until the Value Added Tax comes into force on 5th July 1993, the instrument used is an additional turnover tax collected by the customs administration. From the 5th of July the surcharge will continue as a separate tax. The tax will be 6 per cent until the end of 1993. The Government envisages the possibility of it continuing at less than 6 per cent in 1994. The tax is planned to be discontinued from the end of 1994.

For the time being, the surcharge covers all imports except alcoholic beverages, tobacco products, fuels and automobiles. In preparing the new tax instrument the Government now assumes that the surcharge will be levied on all imports, including alcoholic beverages, tobacco products, fuels and automobiles.

May I note that the comprehensive trade coverage of the surcharge clearly implies that it is not intended to provide relief and protection to any specific industry or sector of the Polish economy. It therefore also meets in this respect one of the essential requirements set down in the Preamble to the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes.

Another fundamental feature of the surcharge is its uniform and non-discriminatory administration with regard to goods coming from all sources of imports, irrespective of the nature of bilateral relations with the countries of origin. This applies to rates, procedures and all other modalities of the measure, and effects equally all trade, including the trading partners with whom Poland's commercial relations are based on Article XXIV of the General Agreement.

The need for the surcharge

In its notification, Poland stated that the measure was taken "*to forestall the imminent threat of a serious decline in Poland's foreign exchange reserves*". The main source of the threat was an unusually severe drought in 1992. The drought has had serious implications, since summer 1992, for the agricultural output and the foreign trade balance. The effects are expected to be particularly strong in 1993 and 1994.

Provisional data about the impact of the drought on agricultural production were given in the original notification delivered to the GATT. Subsequent statistics confirm that the provisional data were fairly accurate.

It is estimated that, in 1992, the total volume of agricultural output dropped by 12 per cent compared to 1991 and by over 14 per cent compared to the 1986-90 average. The output of grains dropped by 8 million tons or 28 per cent, and the output of potatoes by about 6 million tons or over 19 per cent (and by 35.3 per cent compared to the 1986-90 average). In 1992, the output of meat and meat products fell by 4 per cent and is expected to decrease further by another 12-17 per cent in 1993. Moreover, the output of mild and dairy products dropped by 9 per cent in 1992 and this downward trend is expected to continue in 1993, with a further drop of 3-7 per cent. The output losses of these products will have to be made up, in part, by increased imports of grains and animal feedstuffs. These imports already started to emerge in 1992. The food processing industry also needs to supplement domestic inputs, in particular grains, feedstuffs and meat, with imports.

In 1991, agricultural and food exports accounted for 17 per cent of the total exports of Poland with the value of US\$2.2 billion, exceeding the value of imports by about US\$0.5 billion. Preliminary estimates for 1992 show that Poland's net exports in this category fell by about US\$0.5 billion, confirming the forecast contained in the notification to the GATT. These net exports are expected to drop by a further US\$0.5 billion in the year 1993 and to continue at this low level in 1994.

To ease the strong upward pressure on food prices, in October 1992 the Government also established new tariff suspensions for several grains and animal feeds, valid until 31 March 1993. On 24 December 1992, a new Regulation of the Council of Ministers was issued which extended the end date for these tariff suspensions until 30 June 1993. It also introduced prohibitions on the export of a number of animal feeds and export restrictions for some grains and vegetables, all valid until 30 June 1993. Finally, on 9 March 1993, the range of tariff suspensions was broadened to cover all major grains. This new regulation applies also until 30 June 1993.

A special factor

If I may borrow again from the language of paragraph 2 of Article XII, there is a "*special factor*" of primary importance, the presence of which should be recognized in this context. I am referring to the strain on international monetary resources posed by the commitment to sustain and

consolidate the transition reforms in a situation in which the credibility of the macroeconomic policy is not yet strong. In such circumstances, any substantial fall in international reserves represents potentially a greater threat to macroeconomic stability than it would have otherwise.

The surcharge *versus* alternative measures

Poland recognizes the exceptional nature of trade restrictions taken for balance-of-payments purposes. We equally share the view that, in applying such measures, preference should be given to those measures which have the least disruptive effect on trade. It is precisely with this recognition in mind that my Government has chosen to resort to the surcharge rather than to alternative instrument available to us.

Since the principal expected effect of the surcharge is to restrain imports and thereby alleviate the balance-of-payments constraint, we could have chosen a number of alternative avenues, including such measures as quantitative restrictions or stricter foreign exchange controls. We have decided, however, not to take this route of restrictions and controls for the reasons which I now intend to summarize.

Extensive liberalisation of foreign trade is still a relatively new experience for Poland. Its performance depends on three major factors: (1) easy access to trade activities for all natural and legal persons who wish to try their hand in this line of business; (2) privatization of foreign trade operations; and (3) unrestricted availability of foreign exchange. The factors (1) and (2) are closely interrelated. Their one common feature is that they may thrive only in a liberal administrative environment, especially at this early stage of consolidation of the new system. Therefore the Government's policy has been to minimize bureaucratic impediments to the development of free enterprise. Our experience, as well as that of many other countries, clearly indicates that quantitative restrictions inevitably involve excessive red tape, which is inimical to this objective. Another important argument is related to restructuring policy. A major restructuring of the Polish economy is needed, and this would be less successful if imports were excessively regulated by quantity or value. The surcharge is obviously more neutral and less restrictive in this respect.

As regards foreign exchange policy, Poland intends to maintain, protect and expand the present system of virtually unrestricted internal convertibility. The benefits of this system are self-evident. In fact, the convertibility for current account operations has been one of the key instruments in our efforts to construct a truly market economy. The selection of foreign exchange controls, rather than the surcharge, would have meant an unacceptable reversal of this policy.

The exchange rate plays a crucial rôle as a nominal anchor and, in the transition circumstances of high uncertainty concerning the course of macroeconomic policy, it is considered important to retain an element of stability in the rules governing foreign exchange policy.

Finally, the surcharge is considered to be a measure less inflationary than an equivalent devaluation of the exchange rate would have been. In the circumstances when the Government is trying to reduce the inflationary expectations, and indeed the inflation rate itself, the difference favours the surcharge.

Balance of payments and reserves

In 1992, despite a deep recession and a low level of interest payments, Poland achieved a current account deficit of US\$269 million. Moreover, the trade balance has deteriorated since Quarter III of 1992. Provisional data indicate that, in January 1993, the weakening of the trade balance continued, with imports increasing by 18 per cent and exports decreasing by 13 per cent compared to January 1992.

The development of Poland's position in terms of foreign trade, payments, reserves and debt is portrayed by the data in Table 2 of the Appendix.

The tendency of increased trade imbalance in the second half of 1992 has continued in Quarter I of 1993. The relevant data are presented in Table 2. In 1991, according to the payments statistics, the balance of trade showed a considerable improvement in the second half of the year, Poland registering a surplus of US\$383 million. In 1992, there was a strong trade performance in the first half of the year, with a surplus of US\$946 million. However, in contrast to 1991, this was followed by a serious deterioration in the second half, Poland registering a trade deficit of US\$434 million. Moreover, in contrast to the usual quarterly pattern, the trade balance was strongly negative in January and February of 1993. The Government expects a slowdown in the growth of exports to continue, partly because of the drought-induced serious weakening in agricultural output, but also as a result of the current recession in the EC area, particularly Germany. The growth of imports is, however, likely to remain strong, reflecting in part an increasing demand for investment goods, but also a higher demand for agricultural supplies. The imports of consumer durables should slow down, in response to the import surcharge, and this should help to meet the balance-of-payments objectives.

The balance-of-payments position also continues to be affected by the external debt. In 1990-92, Poland managed to improve substantially financial relations with its official creditors. Nevertheless, by the end of 1992 Polish total external debt, mostly towards the Paris Club and London Club creditors, amounted to US\$47.0 billion.

On 21 April 1991, with the Paris Club official creditors was signed a general agreement concerning the debt amounting to approximately two thirds of the total external debt. The agreement included provisions for at least 50 per cent reduction in the net present value (NPV) of the debt stock, expected to be achieved in two stages: in 1991 and 1994. The second stage of the reduction, by 20 per cent, is conditional upon Poland meeting the performance criteria agreed with the IMF for 1993. Our provisional data indicate that Poland met all the criteria for Quarter I, 1993. The unconditional 30 per cent reduction is being achieved mainly through the cancellation of 80 per cent of the interest payments originally due on the Paris Club debt during the three years from April 1991 until April 1994. These three years are therefore a "window of opportunity" for Poland, when the burden of servicing external debt is especially light and when Poland must take action to prepare for the much more difficult years ahead.

Despite reductions by US\$2,401 million, Poland's interest payments due remained high in 1992, equal to US\$2,259 million or about 15 per cent of the value of exports of goods and non-factor services (of which interests actually paid were US\$1,164 million). As noted by the IMF's paper, the ratio of interest to exports is for Poland "significantly higher than the average of 4.5 per cent for countries that have avoided debt service difficulties and about the same as that of heavily indebted countries". And yet this ratio is expected to increase sharply in 1994 and later.

As for external reserves, both official and the total of the banking system, their levels remain adequate. Nevertheless, it is worth noting that official reserves declined somewhat in the fourth quarter of 1992 and substantially in January of this year. Net international reserves have also declined during this period and February 1993, by US\$620 million. There was also a decline of these reserves at the end of 1991, but they recovered in the first quarter of 1992.

I wish to conclude this part of my presentation by stating again that, under the combined impact of all the circumstances mentioned above, and in spite of the surcharge, the payments situation of Poland has deteriorated considerably and is under the threat of a further decline.

Economic policies in 1993

The "*Memorandum of the Government of Poland on Economic Policies in 1993*" is a recent statement of the further stabilization measures and structural reforms which are currently pursued by the Government. On March 8th, 1993 a twelve-month stand-by facility was approved by the Board of the IMF to support the programme. As explained in the Memorandum, the Government's three major objectives continue to be:

- a further marked and lasting reduction in inflation;
- the promotion of structural and institutional changes, in particular privatization; and
- the promotion of closer international economic cooperation.

All three are intended to create macro- and microeconomic conditions conducive to sustained high economic growth.

These objectives are pursued through three complementary packages of measures.

The first package is focused on achieving large and durable reductions in public dissaving, thereby controlling a major source of current inflation, freeing up the credit and saving required by enterprise sector growth, and protecting the external balance. Monetary policy is designed to lower inflation and protect international reserves.

The second package focuses on achieving an improvement in enterprise management and on providing the enterprise sector with incentive and ownership structures designed to make better use of the resources freed up by fiscal consolidation.

The third package aims to strengthen Poland's external financial and trade relations and bring about its closer integration with the world economy through the achievement of a freer and more open trading environment, increased foreign direct investment, export-oriented growth strategy and debt settlements with external creditors.

In pursuance of that objective, Poland has established foundations of the free trade areas with the EC, EFTA and CEFTA, and is attempting to revitalize market-based trade with former CMEA countries. The free trade area with the EC is to be established within the next ten years in the context of Poland's Association Agreement. A similar timetable for the removal of trade barriers is adopted in the agreements with EFTA and CEFTA.

Before concluding, may I reassure all members of this Committee and other GATT contracting parties, that the surcharge does not imply a departure from the generally liberal line of

Poland's trade policies. Among instruments of import regulation, tariffs are and will remain the most essential border measures. We are about to complete our market access offer under the Uruguay Round, including comprehensive tariff binding for the purpose of the Round, and within the framework of on-going renegotiation of Poland's terms of accession to the GATT. This will impart additional stability to our trade policy and will place the surcharge episode in a more predictable context.

Finally, I wish to thank you, Mr. Chairman, for yours and the Committee's positive response to our sincere intention to consult with the Committee as early as possible. I would also like to thank the Secretariat of the GATT and the IMF officials, both in Washington and Geneva, for their helpful cooperation in preparing this review.

I and my colleagues stand ready to respond to questions and comments from you and other members of the Committee. We count on your understanding and friendly partnership.

Table 1
Poland - Trade in food and agricultural products

	1990		1991		1992	
	First half	Second half	First half	Second half	First half	Second half
Exports ¹	16.8	14.4	17.5	15.9		
Imports ²	9.9	9.7	13.8	13.5		

- 1 The data concerns the share in total exports in the given period.
2 The data concerns the share in total imports in the given period.

Table 2
Poland - Balance of payments in convertible currencies - on cash basis, official reserves and the amount of foreign debt (US\$ million)

	1990		1991				1992				1993	
	I-IV	I	II	III	IV	I-IV	I	II	III	IV	I-IV	Jan.
Exports	10,863	2,823	3,268	3,179	3,490	12,760	3,310	3,545	3,513	3,629	13,997	867
Imports	8,649	3,081	3,342	2,695	3,591	12,709	2,925	2,984	3,440	4,136	13,485	1,136
Balance of trade	2,214	-258	-74	484	-101	51	385	561	73	-507	512	-269
Current account	716	-1,134	-531	533	-227	1,359	133	206	-60	-548	-269	-244
Overall balance	1,938	-189	-726	474	-747	-1,188	12	311	232	-82	473	-351
Official external reserves ¹	4,680	4,493	4,087	4,561	3,814	3,814	3,826	4,136	4,368	4,287	4,287	3,936
Foreign debt ²	48,475	45,225	44,766	45,091	48,412	48,412	45,455	48,196	50,289	47,044	47,044	

- 1 End of period.
2 In convertible currencies only.

Table 3
Poland - Net international reserves (US\$ million)

	1990	1991				1992				1993			
		I	II	III	IV	I-IV	I	II	III	IV	I-IV	Jan.	Feb.
Changes ¹	-	-773	-936	827	-435	-	104	836	991	-317	1,614	-104	-203
						1,317							

- 1 As from the end of the previous period.

Annex II

Statement by the Fund Representative to the
GATT Balance-of-Payments Committee

In January 1990, the Government of Poland launched an ambitious program to stabilize the economy, restore external viability, and lay the groundwork for transformation to a market system. The process has been protracted and difficult, significantly due to the far-reaching and greater-than-foreseen impact on output and foreign trade of the dismantling of the CMEA trading arrangement and the disarray in the former U.S.S.R. Nevertheless, successive governments have reaffirmed their commitment to the transformation process and have persisted with stabilization and reform efforts. These efforts have been supported by the international community, including the International Monetary Fund. On 8 March 1993, the Fund approved a twelve-month stand-by arrangement with Poland in an amount of SDR 476 million that will support a strengthening of stabilization and reform policies.

The Government's efforts thus far are being met with increasing success. Following two years of sharp decline, the Polish economy experienced a turnaround in economic activity in 1992. The private sector has played a dominant rôle in the recovery process, and now accounts for nearly one half of both GDP and employment. Inflation has fallen markedly from the near hyperinflation rates at the beginning of the transformation process, and confidence has been restored in the zloty as a store of value. The official external reserve position has improved significantly.

However, serious fiscal pressures have emerged since 1991, with the unanticipated collapse of revenues and rising social expenditures. The general government balance recorded a deficit of 5½ per cent of GDP in 1991, and this widened to 7½ per cent of GDP in 1992. The growing fiscal imbalance is inconsistent with the achievement of sustained non-inflationary growth, and is a direct threat to external viability over the medium term as well as to public confidence in the reform process. More immediately, the deterioration in the fiscal situation represents a clear and present threat to the positive trend of inflation expectations established over the past period. Such a break would trigger pressures on external capital flows, which in turn would, among other things, raise pressures for protectionist measures. In 1993, therefore, a major thrust of Government policy is to rein in the fiscal deficit. Important measures have been initiated to widen the tax base, strengthen tax administration, and carry out social insurance reforms. However, because the effects of these measures will only be felt gradually, the Government has taken immediate steps to cut discretionary current expenditures by a substantial amount and to boost revenues. These measures are projected to bring the general government deficit down to 4.7 per cent of GDP, a level which is considered to be the maximum permissible without endangering near-term stabilization and the prospects for attaining the medium-term macroeconomic objectives.

Structural reforms already implemented include a major liberalization of the trade and payments system. Nearly all quantitative restrictions were eliminated at the beginning of 1990. A few quantitative restrictions (mainly on fuels, tobacco and spirits) remain or were reintroduced on a temporary basis. These will be eliminated when the planned restructuring of the domestic fuel industry is completed and border tax administration is sufficiently strengthened. Import tariffs, suspended in August 1990 with a view to stimulating domestic activity and lowering the price of machinery and other imports needed for restructuring, were reimposed at an average level of about

18 per cent in August 1991 in response to a deterioration in the balance-of-payments situation. Some further modifications to the tariff schedule, covering goods such as cars, computers and cigarettes, among others, were carried out in early 1992. In December 1991, Poland signed an association agreement with the EC, which provides for the phasing out of import barriers over a ten year period. Other regional free trade arrangements have been signed with EFTA countries, and with the Czech and Slovak Republics and Hungary.

A new foreign investment law was enacted in 1991 that allows for full remittance abroad of profits and dividends, and permits repatriation of equity. In 1993, the Government intends to remove the remaining restrictions on current account transactions including allowing the repatriation of profits and capital in certain portfolio investments.

Progress toward external viability received a sharp boost from the liberalization of the trade and payments régime, the opening of the EC market, and the substantial cash-flow relief provided by the 1991 Paris Club debt reduction agreement. These factors, combined with policy induced effects and unanticipated inflows of short-term capital led to an increase in reserves in 1992 which offset the decline in 1991. Nevertheless, the external outlook remains fragile, even based on the premise that conditions for sustained positive growth are present and that the authorities adhere to a strong stabilization and structural reform program. Export growth is expected to slow down because of weaker demand in major trading partners and the tapering off of the stimulus imparted by the improved access to the EC market. At the same time, imports can be expected to grow more rapidly, because of the need for investment goods to support the restructuring efforts. Net exports are also likely to weaken because of the drought last summer. In 1993, reserves are expected to fall to just above two months of imports (from over three months in 1992) as a debt and debt service reduction operation with commercial bank creditors, currently under negotiation and expected to be concluded this year, is financed in part from Poland's own resources. Reserves will remain under pressure as debt and debt service obligations increase sharply when the five year grace period associated with the Paris Club agreement runs out, and continue to rise into the next decade. In view of these developments and to avoid short-circuiting the effectiveness of the interlinking set of policies in the structural and macroeconomic areas, the Polish authorities introduced a temporary import surcharge of 6 per cent in December 1992. The Government views this surcharge as a temporary measure, and is committed to reducing it to 3 per cent in 1994 and eliminating it at end-1994. The staff's medium-term balance-of-payments scenario prepared in the context of the stand-by arrangement shows gross reserves averaging 3.5 months of imports during 1994-2000, a level which is considered essential for preserving the credibility of the Polish reform and stabilization efforts, especially since the Polish Stabilization Fund has been unwound at end-1992.

Poland has made significant progress in the transition to a market-based system, against considerable odds. Trade policies and exchange system reforms have been geared toward reducing distortions to trade, encouraging market forces, and integrating Poland into the world economy. It is to protect the implementation of the liberalization measures and to assure their continuity that the temporary import surcharge found policy support. The Fund commends the Polish authorities on the steps taken thus far. With adherence to the Government's program, a strengthening of the balance-of-payments and the fiscal situation should permit the withdrawal of the import surcharge as scheduled and the removal of remaining import restrictions. To clarify, I would like to return again to the basic economic relationship between the external sector and the fiscal deficit, particularly when private sector savings are not high. It is on the basis of this relationship that the Fund sees the imposition of a temporary import surcharge justifiable for balance of payments reasons.