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October 6, 1989

To: Members of the Executive Board

From: The Acting Secretary

Subject: Economic Reform in Poland Since 1981

The attached paper on economic reform in Poland since 1981, together with the papers on economic reform in Hungary since 1968 (SM/89/203, 10/5/89) and economic reform in China since 1978 (SM/89/205, 10/6/89), provide background information for the Executive Board seminar discussion of market-oriented reform in planned economies (SM/89/202, 10/5/89).

Mr. Wolf (ext. 7413) is available to answer technical or factual questions relating to this paper prior to the seminar.

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Economic Reform in Poland Since 1981

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I. Introduction

Among the centrally planned economies, Poland has a relatively long history of reform initiatives aimed at decentralizing economic decision making. The history of Polish economic reform, however, is by no means one of continuous movement in the direction of decentralization and market orientation.

As early as 1956-57, following the first of the sociopolitical crises of the postwar era, a reform was formulated under Government auspices which was designed to move away from the pervasive directive planning that characterized the classical centrally planned economy (CPE). It was only partly implemented, however, and was largely reversed in later years. Subsequently, there have been repeated attempts to move away from the traditional practices of the CPE, with particularly significant reform programs being formulated after the sociopolitical crises of 1970-71 and 1980-81.

The reform program of 1981-82, which in principle represented the most far-ranging reform of the economic system attempted since the establishment of central planning in the late 1940s, was adopted in the midst of a serious collapse of the economy and social turmoil. It was a period of large external imbalances and growing internal imbalances and this situation, combined with the attempts by the prevailing administrative apparatus to preserve its traditional prerogatives and position, led to a less-than-complete and at times half-hearted implementation of the reform program. By 1984-86 the reform process was at a "crossroads," but by 1987 the push for reform had revived among official circles and in late-1987 and 1988 a "second stage" of economic reform was launched. This renewed commitment to reform received additional impetus from initiatives carried out by the new Government that took office in late 1988, and the agreements arrived at during the unprecedented social roundtable discussions concluded in April 1989.

By mid-1989, a number of reform initiatives had been implemented, particularly in the context of the "second stage" of reform. These initiatives included a far-reaching formal restructuring of the central economic administration and the role of central planning, a reduction in the formal central allocation of inputs, a reform of the exchange rate system and liberalization of the allocation of foreign exchange, and in the summer of 1989 a substantial liberalization of the agricultural and food sectors. Much less progress had been achieved, however, in other areas, including in establishing financial discipline for enterprises at the microeconomic level and therefore in achieving adequate financial control at the macro level. This was particularly manifest in the acceleration of the growth of money wages. Evaluation of the impact of the reforms on the economic performance of the economy as a whole, and indeed the very sustainability of many of these reform initiatives, was clouded by the authorities' continuing inability to carry out a set of financial policies sufficient to restrain the growth of incomes to a level at which excess demand pressures could be reduced. These pressures were still increasing in mid-1989 and, to the extent they were growing at a rate greater than the population's tolerance level for open inflation, they threatened the process of liberalization in several areas of the economy.

Section II of this paper briefly reviews the background for economic reform in the 1980s with particular stress being laid on the reform waves of 1956-57 and 1973-75; the overall blueprint of the 1981-82 reform is presented in Section III. The subsequent Sections IV through X discuss respectively the reform initiatives since 1981 in seven areas: (1) the system of microeconomic decision-making, including the issues of enterprise autonomy, property rights, financial discipline and attempts to increase competition; (2) the structure of prices and the price system; (3) the foreign trade and exchange rate systems; (4) the wage system and labor market policies; (5) fiscal reforms; (6) the development of integrated money and capital markets, including reforms in the banking system; and (7) agriculture. Most of these facets of the economic system obviously overlap, and these categories are adopted mainly to facilitate exposition.

II. The Legacy of Traditional Central Planning and Reform

By the mid-1950s the economic system in Poland was a classical CPE patterned after the Soviet system of that period. The main deviation from the traditional CPE model was the still predominant private ownership of agriculture, despite a policy of collectivization inaugurated in 1950. 1/ In other sectors of the economy, the system in all major respects was similar to the classical CPE described in the main paper.

The systemic features of this model were combined in Poland, as in other CPEs, with a strategy of very rapid industrialization based mainly on the equally swift mobilization of capital and labor (so-called extensive development). High rates of capital formation were made possible by planning for relatively slow growth of consumer goods output, thereby achieving forced savings. The rapidly growing labor force in industry was drawn mainly from agriculture which, along with the production of industrial consumer goods and services became one of the neglected sectors of the economy. The Polish United Workers' Party (PUWP) and the Government sought support for this economic system and their objectives on the basis of the economic policy pillars of retail price stability, low prices for staples such as food and housing, an egalitarian wage structure, full employment, and a degree of individual job security not to be found in market economies.

1/ By mid-1956 only 11.2 percent of Poland's agricultural land had been collectivized (Montias (1962)).

1. <u>The 1956-57 reform program</u> 1/

In the months preceding the social unrest and change in Party leadership of October 1956, the highly centralized, command-style economic system came under increasing public criticism in Poland. While the socialist underpinning of the system was not generally questioned, excessive centralization in planning and management was, and some observers went so far as to recommend the adjustment of the structure of production in response to market signals.

In November 1956, the parliament (Sejm) enacted legislation that formally reduced the powers of the center vis-à-vis the state enterprises. The legislation provided for a reduction in the number of annual plan targets. At the same time, the State Commission for Economic Planning, which had supplanted a less intrusive Office of Central Planning (in 1948), was renamed as the Planning Commission of the Council of Ministers and reconstituted with half the number of staff, a transformation designed to remove it from economic decision-making and establish it as an advisory staff organ. Another law enhanced the formal autonomy of enterprise management with respect to the establishment of work norms and profit-sharing.

The pressure for decentralization of decision-making was also reflected in a more or less spontaneous growth of workers' councils at the factory level which now competed with the officially sanctioned plant councils representing the official trade unions. In part influenced by the Yugoslav experience, the authorities also supported legislation providing for the establishment of workers' councils, although their operation and the delineation of their authority were described in this legislation in only general terms.

While these measures were being elaborated and enacted, a wide-ranging public debate took place on the need for and the modalities of reform. There was increasing talk of the need for democratization, including the establishment of a second parliamentary chamber that would ensure the representation of various self-management organs. In the spring of 1957 a commission composed of economists representing a spectrum of views, created by the new Economic Council attached to the Council of Ministers, published a list of "theses" on reform. These may be seen as a kind of compromise program, fully reflecting neither the views of the more radical proponents of market-oriented reform nor those who preferred maintaining the status quo.

The theses were divided into three broad categories, dealing respectively with central planning, the organization of industry, and the instruments for "the planned management of industry." In respect of central planning, the theses suggested that a "deepening and improvement of central planning" required greater emphasis on strategic planning and

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1/ This period is discussed in detail by Montias (1962).

economic analysis and less on the issuance of specific orders and intervention by the planners in everyday activities in order to ensure plan fulfillment. Economic information was to be "declassified," so as to enhance the "democratization of economic management," including the participation of workers and workers' councils (Economic Council [1957]).

Even had the theses been fully implemented, the Polish economic system would have fallen considerably short of what is usually considered "market socialism." 1/ In the theses, planning still played the dominant role, and taken as a whole, the theses presented an ambiguous picture of the relationship between the now more autonomous enterprises, the intermediate levels of the economic hierarchy, and the center. While the theses suggested that "the directives of the central plan should not conflict with the economic calculations of the firm," enterprise autonomy clearly was to be limited in various ways, and the theses did not provide guidance as to how inevitable conflicts between intermediate administrative levels, with plans to fulfill, would be reconciled with the greater autonomy and profit orientation of firms. Authority within the firm was to reside with the workers' council and the enterprise director, but the division of their authority was not specified. Given the many ambiguities in the theses, it is difficult to imagine how a reassertion of central control as well as authority at the intermediate levels, at the expense of enterprise autonomy, would not have inevitably taken place.

Central allocation of basic inputs in short supply was assumed by the theses, and the idea of free market pricing was generally excluded; clearly, a situation of more or less perpetual disequilibrium was implicitly assumed. An administered reform of both producer and consumer prices was advocated, but the implicit model contained no mechanism for ensuring the more or less constant changes in prices necessary to keep disequilibria at a minimum over time. Although interest rates were viewed as an important instrument for the "planned management of industry," no recognition was given to interest rates as an incentive for household saving. Implicitly, with the overall level of investment being determined at the central level, the rate of saving would not be determined by the market, and with prices fixed for long periods households generally would be in disequilibrium.

1/ This despite the fact that the head of the reform commission was Oskar Lange, author of the famous "competitive" model of market socialism. Indeed, in his own writings in this period, Lange, although a critic of excessive centralization of the Polish economy, visualized only a negligible role for the market in the determination of prices (Lange [1956], Pajestka (1987)). In his celebrated theoretical model he had earlier proposed free prices for consumer goods and administered pricing for producer goods, with the latter intended to be highly responsive to changes in market conditions (Lange [1936-1937]).

Although the reform blueprint was generally not implemented and the aforementioned reforms that actually were taken were later reversed or emasculated, 1/ the theses may be viewed as containing the intellectual seeds of later reform efforts in Poland, as well as in some other East European countries. The theses articulated two critical insights into the nature of the CPE. One of these was that the center could never have at is disposal adequate information with which to plan efficiently economic activity at the micro level. The other was that efficient planning and carrying out of such activities could not be done at the enterprise level either unless enterprise managers were given sufficient authority, responsibility and incentives to plan and utilize the resources at their command in the most efficient way. To ensure that these incentives led enterprises to operate in ways that were also efficient from society's point of view and would correspond to the priorities of the planners, the incentive system would have to be based on a price system that efficiently reflected relative scarcities as well as these priorities.

The theses also suggested that the effectiveness of a socialist, centrally planned economy could be improved through a greater dispersion of economic decision-making and the use of various indirect "economic instruments" by the authorities, such as prices, interest rates, taxes, tariffs, and "import-export coefficients." But while many of these instruments had counterparts in market economies, it was not intended that their values be shaped by the unleashing of market forces in the Polish economy or that their values should necessarily even simulate those that would be determined by more or less free operation of markets. The theses therefore fell short of creating a complete paradigm for market-oriented reform in Poland; rather, they provided a framework for later discussions of how partial decentralization and the use of indirect instruments might replace the traditional command-distribution system as the basis for achieving the goals of the central planners.

2. The reform of 1973-75

The early 1960s were characterized by a reversal in the implementation of reform as well as a lack of theoretical work on the subject. In the late 1960s, however, partially in response to a slowdown in economic growth, a new wave of reforms was initiated. These

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1/ For example, a 1958 decree of the Council of Ministers provided for the creation of industrial associations, which essentially recreated the functions of the old central boards and significantly circumscribed the autonomy of enterprises (Montias (1962), Zielinski (1973)). By 1958 the law on workers' councils had been modified so as to create "conferences of workers' self-management" which effectively subordinated the workers' councils to the trade union committees of enterprises and to political directives (Brus (1988)). The decollectivization of agriculture, however, begun in 1956, was not reversed.

reforms were of a generally limited scope, dealing with such issues as the system of success indicators, managerial incentives, planning the wage fund of enterprises, and the use of shadow exchange rates in planning foreign trade (Trzeciakowski (1962)). Although the Fifth Congress of the PUWP, meeting in 1968, called for a "comprehensive and internally consistent system of planning and management," the next few years were characterized mainly by continued partial reform measures (Zielinski (1973)).

A much more comprehensive reform program was formulated in 1971-72 under the direction of the new Party leadership that assumed power after the economic and political crisis of late 1970. So-called large economic organizations (WOGs--Polish acronym) were established consisting of associations of state enterprises, combines, and multiplant enterprises (subordinate to the branch ministries). These groupings of enterprises were given a new legal status designed to provide them with autonomy and a certain degree of accountability. The intention was also to reap the alleged advantages of concentration, which was viewed as an inexorable process taking place in all economic systems (Nuti (1977)).

The objective was not to establish a fundamentally new economic model, but rather to perfect the system of planning and management so as to improve its capacity for achieving the central plan. Although the autonomy of the associations and their subordinate enterprises was to be increased, the accuracy and effectiveness of central planning were at the same time to be strengthened through the establishment of a system of economic parameters, determined by the planners, which would "steer" economic units toward making the right decisions in light of the planners' objectives (Fallenbuchl (1977)). Direct commands would be generally replaced by the manipulation of these economic instruments. 1/

A WOG introducing the new system was expected to maximize some combination of its value added and profit. The authorities provided the WOG with two remuneration norms, one which permitted the wage fund to grow at a rate that was positively related to the WOG's rate of growth of value added and the second which linked managerial bonuses to the

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1/ An important feature of this reform program was that while a reasonably comprehensive set of instruments was elaborated for the WOGs, this new economic financial system was initially introduced, at the beginning of 1973, on a pilot basis in only a subset of these organizations. By the end of 1975, some 125 WOGs had adopted the system, of which 110 were industrial organizations accounting for two thirds of industrial output (Fallenbuchl (1977)). Expansion of the new system to additional organizations had been contemplated for later years, but this was effectively nullified by the changes in system initiated in response to the severe macroeconomic imbalances that emerged in Poland in the mid-1970s.

rate of growth of profit. 1/ These norms were in fact the subject of intensive individual negotiation between the WOGs and the Planning Commission, with the latter at a disadvantage because it did not possess sufficient information or even a methodology with which to set uniform norms (Wanless (1980)). Furthermore, the WOGs were permitted to choose the precise definition of value added to which the wage fund norm was to be applied, and they could themselves decide how to divide up the permitted increase in the wage bill among their constituent enterprises. In effect, this meant that there would be little if any necessary connection between the wage increase of the individual worker (enterprise) and his (its) performance.

The center in effect attempted to induce the WOG's to draw up "parallel" plans based on their own self-interest, which would essentially match, at least in the aggregate, the center's own output and value targets (Piotrowski (1980)). In addition to negotiation of the remuneration norms, the center in principle was to use two types of parameters to influence the WOG and its enterprises. One group, consisting of price-setting rules, interest rates, amortization rates and a so-called internal exchange rate, was meant to inform the WOG of the general state of economic activity.

In foreign trade, settlements were to be at so-called transaction prices equal to the product of the foreign currency price, the external or deviza exchange rate, and the internal exchange rate. As domestic producers were intended to trade through FTOs on a commission basis, and in principle were not to receive foreign trade directives, they would have an interest in comparing transaction prices with those paid or received domestically, and to take decisions accordingly (Plowiec (1973-74) and Böhm (1985)). WOGs were also permitted to retain a certain amount of their foreign exchange proceeds earned through exports, according to a norm set on an individual basis. The domestic price reforms, intended to retain indirect centralized control over price formation, but to leave the setting of individual prices to the WOG and its constituent enterprises, were fundamentally cost-oriented; little apparent attention was given to using prices to eliminate or reduce market imbalances. In the event, the domestic pricing reforms were not carried out (Wanless (1980)).

A second set of "supporting" parameters at the disposal of the authorities was composed of so-called subjective subsidies (i.e., direct subsidization of firms rather than "objective," or price subsidies), price-equalization subsidies and taxes, and the structure of tariffs. These parameters were meant to reflect the planners' sectoral priorities. In addition, under the new system the center was not deprived of

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1/ Nuti (1977) and Kemme (1982) have shown that theoretically this joint maximization procedure would lead enterprises to produce a lower level of output, with a given budget constraint, than if they were simply to maximize profit.

the authority to set obligatory targets or norms, in the form of direct commands to the WOGs. The latter, in turn, were still authorized as well to issue direct commands to their constituent enterprises.

The scope for market relations, aside from the only limited possibilities for free price formation, was constrained by the hierarchy of direct commands which was still permitted within the new system, as well as by the fact that a sizable part of the economy, aside from the WOGs employing the new system, was still subject exclusively to the old command-directives approach.

Since the central planners had not given up the objective of meeting a series of quantitative and value targets, and there was no built-in (market) mechanism to remove market imbalances, it was almost inevitable that the set of parametric instruments they had at their disposal would be inadequate to achieve their objectives with any precision. It is unclear why it was believed that employing a set of indirect instruments, with no experience as to the functional relationship between them and various indicators of economic performance, could actually increase the accuracy and effectiveness of central planning. In the event, the possibility of a true test of the effectiveness of this system of indirect instruments in raising economic efficiency and meeting the goals of the central planners was precluded by growing macroeconomic imbalances. Introduction of the WOG reform coexisted with a "new development strategy" designed to modernize industry and accelerate economic growth through massive imports of machinery and equipment from the convertible currency area. In the 1971-75 period import volumes from nonsocialist countries grew at an annual average rate of over 25 percent, investment increased at an annual rate exceeding 15 percent, and NMP by 10 percent per annum. This strategy was accompanied, however, by rapidly growing internal and external imbalances, and by 1975 Poland was running a current account deficit in excess of US$3.0 billion, or more than 10 percent of NMP. 1/

Although the deterioration in the macroeconomic balance was essentially policy determined, some facets of the new system may also have contributed to it. The enhanced power of the intermediate level organizations as well as the branch ministries under the reform may have influenced the phenomenon of the "open plan," whereby elements of the published central plan would be subsequently amended several times through negotiation. In these negotiations the industrial branches and the WOGs would "hook onto" overly-ambitious output plan adjustments so as to increase their claims on funds for investment and convertible currency imports (Trzeciakowski (1980); Böhm (1985)). As a result, virtually all plans came to be exceeded by large margins.

1/ At the then commercial exchange rate (the deviza exchange rate multiplied by the official internal rate).

The policy-induced growth in incomes and therefore in demand pressures may have been reinforced by the new WOG financial system. In a climate of excess demand, enterprises could relabel traditional goods as "new" products for which higher prices could be charged without losing sales or actually incurring increased costs. This would raise measured value added and permit the WOGs under the new wage system to increase wage payments (Wanless (1980); Gabrisch (1981)). Despite the rapid growth in demand, the authorities in general tried to keep a fairly tight lid on prices, and the economy was consequently faced with growing excess demand pressures and price distortions. The policy of keeping a rein on open inflation extended to foreign trade. In the face of sharply accelerating world market prices in the wake of the first oil price shock, the Polish authorities did not let FTOs pass the higher transaction prices for imported inputs on to Poland's highly material-intensive industries. At the same time, the transaction prices of exported goods rose rapidly. The net result was an increase in effective protection for a wide range of processing industries, and the now more autonomous WOGs were given the incentive to increase their imports for processing and re-export (Böhm (1985)). 1/ The authorities finally responded with a windfall profits tax levied on such exports.

As the macroeconomic environment deteriorated, the authorities made various adjustments to certain "parameters" faced by enterprises, including changes in the magnitude of the remuneration norms, increases in turnover taxes on new products, and the above-mentioned windfall profits tax on exports. Such changes proved to be inadequate, however, and by 1976-1977 the authorities had not only initiated major modifications in the system, 2/ but had increasingly turned to direct controls in order to limit, as in the case of excessive imports, some of the more serious manifestations of excess demand. Direct price controls had been strengthened at the expense of the rules for decentralized price setting. These controls, which were the object of intense negotiation with the intermediate levels, increasingly lacked a basic coherence. By the late 1970s, different WOGs were operating quite different systemic rules, many in fact never having introduced the basic reformed system of 1973-75. The cutbacks in imports of inputs and machinery and in investment in the late 1970s were unaccompanied by reductions in the real wage and real consumption, and domestic bottlenecks and imbalances continued to grow, helping to spark the sociopolitical crisis of 1980-81.

The WOG reform blueprint countenanced a greater role for central directives and for the intermediate levels in the economic bureaucracy, than did the earlier reform blueprint of 1957, and it did not provide for self-management within the enterprise. But there were also some

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1/ A model of this type of phenomenon appears in Wolf (1980).
2/ For example, the original "R" norm for the wage fund was replaced in 1977 by the "O" norm, which restricted the growth in the average wage.

similarities to the earlier program. The 1973-75 reform sought to combine only partial decentralization with the use of indirect planning instruments, with the latter falling far short of the exogenous, uniform and nondiscretionary parameters faced by the competitive enterprise in the stylized market economy. It also emphasized improvements in the incentive and information systems, while neglecting the need for financial discipline at the enterprise level. The consequence of the latter in the event of poor management--bankruptcy--was scarcely mentioned in either the 1957 or 1973-75 reform programs.

A widespread perception among reformers in Poland during the period of economic collapse (1979-82) was that the reforms of the past, including the WOG reform, had been too gradualist, both in the sense of restricting the reforms to "experiments" in certain sectors of the economy, and in terms of introducing only certain reform initiatives as an initial step toward a possibly more comprehensive reform at a much later stage. Many observers came to the conclusion that partial reforms, in either sense, would risk easy rejection by the surrounding, traditional system, as if they were "unwelcome transplants." In this view it was necessary to identify the critical mass of the economic system that had to be fundamentally changed if the reform were to survive and, better yet, to aim at comprehensive reform "at one go" (Zielinski, 1980).

The growing macroeconomic imbalances of the 1970s were viewed as having sealed the fate of WOG reform and precluded further liberalization of the economic system. A widespread view was that reform could only be successfully pursued in a situation of economic slack and balanced growth. By the early 1980s, the collapse of the economy had, in this sense, worsened the prospects for successful, immediate reform. Most observers, however, blamed not only failures in economic policy but also defects in the system for the debacle of the 1970s. It was evident to them that reform was a necessary precondition for sustained economic recovery. The economic collapse was also accompanied by unprecedented labor and social unrest and demands for greater "socialization" and "democratization" of the economy, including increased worker participation in enterprise management. The challenge for policy makers on the threshold of the 1980s was therefore how to elaborate an effective program that reflected the recognition that: (1) reform was most likely to succeed in a period of general economic balance; (2) the social and political impulses for reform, however, were actually likely to be greatest during periods of crisis; and (3) reform was indispensable if the economy were to achieve sustainable growth and make up for the years of economic collapse.

III. The Framework for Reform Since 1981

1. *The 1981-82 reform blueprint*

Virtually all the reform proposals elaborated during the socioeconomic and political crisis of 1980-81 were built on the basic premises of the 1957 reform blueprint discussed in Section II.1. These premises included the need to provide enterprises with sufficient autonomy, responsibility and incentives to operate efficiently and to display entrepreneurship, and the necessity of establishing an information system that efficiently provided signals as to relative scarcities and the priorities of the planners.

A further premise of the 1957 theses, but one that had not been reflected in the 1973-75 program, was the need for the "democratization" of economic life above and beyond the granting of increased autonomy to enterprises. This premise was revived during the 1980-81 reform discussions, as many of the participants sought to establish mechanisms for organized social control of economic policymaking and the reform process. Given the dramatic overheating of the economy in the 1970s, and the ensuing economic collapse, it was widely thought that a key element of a renewed reform effort should be the institutionalization of measures to hold policymakers accountable.

Several reform proposals were elaborated in this period, with the ultimate "blueprint" emerging from revised proposals of an original joint Party-Government commission (PTE (1980)) in the form of a reform program accepted by the Ninth Congress of the PUWP in mid-1981, and in legislation adopted in late 1981 and early 1982. The two main objectives of the reform were to increase economic efficiency and to restore and maintain market balance. The principles of this program can be summarized under three main headings: "socialization" of the planning process, fundamental changes in the system of microeconomic decisionmaking, and the strengthened role of "economic instruments."

The call for "socialization" of the planning process meant in effect that the near-monopoly position of the PUWP in the formulation of economic policy and reform was to be replaced by a system providing for wider participation in policymaking at all levels. The intention was to enhance the effective policymaking role of the Sejm as well as the Council of Ministers, to provide for various organized consultation groups on economic policy and reform, and at the enterprise level to revive the principle of self-management through workers' councils.

The greatest emphasis in the reform program was placed on the need for fundamental changes in the system of microeconomic decisionmaking. The program was based on three principles--enterprise self-dependence, or autonomy; self-management; and self-financing. Implementation of the program in this area is discussed in Section IV.

The principle of enterprise autonomy was to involve a number of fundamental changes in the existing system, including a streamlining of the central economic administration and reducing the number of branch ministries to one or two, and a basic shift in the responsibility of the Planning Commission from largely short-term planning and operational tasks to a longer-run, more analytical and advisory role. This would mean, inter alia, the general abolition of the center's ability to "address" specific targets and tasks to enterprises, a reduction in the scope of central allocation of material inputs and foreign exchange, and a diminished scope for the issuance of general commands and prohibitions to the enterprise sector. The plan targets incorporated in the annual plan were no longer, in general, to be binding on enterprises; henceforth, the center would attempt to achieve these targets through the use of economic instruments. The decline of the role of directives and the increased importance of these instruments, however, was to take place over time. At the intermediate level, obligatory associations of enterprises were generally to be abolished.

All economic entities, whether state enterprises, cooperatives, or private firms, were to be considered equal under the law. Profile restrictions on enterprises were to be reduced or abolished, as were the monopolies over foreign trade operations enjoyed by the FTOs. The degree of monopolization was to be reduced in general. There was to be an expansion of local control over state enterprises, at the expense of the center, and new ownership forms, including joint stock companies and joint ventures were to be encouraged. The influence of the Party at the level of the enterprise was to be reduced, including in the appointment of managers. At the same time, workers' councils, which were to be the main mechanism for realizing the principle of self-management, were to be established that would have wide-ranging powers. Enterprises were to be given substantial autonomy regarding the structure and level of wages.

Enterprise self-financing meant that firms would be subjected to financial discipline. Bankruptcy was to be the ultimate penalty for the chronic loss-making enterprise, although it was recognized that financial discipline could be increased only gradually in order to avoid major dislocations and unemployment. This discipline was to be imposed by both the banking system and the budget. With regard to the former, the autonomy of the NBP from the Government was to be enhanced thereby ending its passive accommodation of the credit demands of enterprises. Possibilities would be established for the creation of new banks that would extend credits generally on the basis of economic criteria. Budgetary subsidies to enterprises were to be reduced, although the reform program was not very explicit regarding the policy with respect to the uniformity of budgetary treatment of enterprises (concerning taxes and subsidies) and the scope for discretionary subsidies or tax reliefs. The system of taxation was to become "the basic instrument of shaping the relations...between individual enterprises and the state" (Plenipotentiary (1982)).

The third general set of principles involved the economic instruments to be used to guide enterprise activity in the direction of the priorities of the planners as well as in the efficient use of resources. In addition to interest rates on credits and the structure of budgetary taxes and subsidies mentioned above, the basic instruments emphasized in the reform documents were the publication of central balances for basic inputs, product prices, the exchange rate, and wages. The balancing of basic material inputs was to be largely of an informative nature, although it was recognized that certain inputs would have to be centrally allocated at the outset of reform due to the economic crisis situation. Prices were to be flexible and shaped according to three criteria: the level and structure of world market prices, "socially justified" costs of production, and the need for market balancing. The exchange rate was to be unified, for each currency region, for commercial transactions, but it was to be at the outset a "submarginal" rate that would ensure the profitability of about three-fourths of all exports; 1/ convertibility, however, was a long-term objective. From the beginning, exporting firms were to be able to retain part of their convertible currency earnings. Although wage determination was to be decentralized, the authorities could still seek to influence the overall rate of wage growth through taxation of the enterprise wage fund. In addition to these various indirect instruments, the planners were also to retain various direct controls and would also directly influence economic activity through the purchases of the government. 2/

Although the principles of the reform blueprint that evolved in 1981-82 were broadly those set forth in the 1957 reform theses, in many areas they were considerably more explicit and ambitious with regard to the need for enterprise autonomy, financial discipline and the general call for "socialization" of the planning process, as well as in respect of reform of the product markets and the price system, and reform of the foreign trade and exchange rate systems. This greater specificity and in some cases more far-reaching goals no doubt reflected in part the generally disappointing experience with reform in the intervening quarter century and, in particular, the extent of disillusion with the traditional system that had been so closely associated with the economic collapse following 1978.

As introduction of the reform took place, beginning in some areas in the second half of 1981, output continued to fall and the extent of disequilibrium, particularly in the market for consumption goods, increased. Between 1978 and 1982, NMP fell by almost 25 percent, and in 1981 socialized enterprises recorded a net loss in the aggregate while

1/ For the definition of profitability, see footnote 1, p. 38.
2/ Discussions of the reform blueprint of 1981-82 include Adam (1986), Balcerowicz (1988), Fallenbuchl (1986), Gomulka and Rostowski (1984), Nuti (1986), Pajestka (1986), Plenipotentiary (1982) and Sadowski (1982).

the household saving rate, reflecting continued growth in the real wage combined with the decline in real consumption, virtually doubled to about 17 percent. Labor unrest continued as well, and in December 1981, the Government imposed martial law and a temporary suspension of all independent political activities, including those of the trade union movement "Solidarity." As a result of these developments the initial implementation period of the reform coincided with an unprecedented degree of economic collapse not even foreseeable at the time the reform program had been elaborated. Moreover, one of the key principles of the reform, the socialization of the planning and reform process, was effectively eliminated for the time being by martial law.

In most of the areas discussed in Sections IV through X important reform initiatives were taken in the period 1981-1986, particularly in the earlier years. In virtually every case, however, these initiatives fell short of what had been envisioned in the reform blueprint. Economic activity did begin to revive in the second half of 1982, and in the next four years NMP rose at an average annual rate of 5 percent. Nevertheless, aggregate output in 1986 remained below its peak level of 1978, and real private consumption per capita, despite growth during this period averaging 3.5 percent annually, remained below its peak level of 1980. By 1985-86 there was increasing public discussion of whether the reforms that had been implemented were adequate to ensure more than a return to precrisis levels of activity and provide for sustainable growth over the longer term.

2. The second stage of reform: 1987-present

For some influential observers, the reform appeared to be at a "crossroads" in 1984-86: unlike the earlier reform efforts, the reform program initiated in 1981-82 had not yet been set aside but the influence of the groups opposed to reform was growing while pro-reform elements were seen to be losing strength. Obstacles to a deepening of the reform were evident in several areas. Popular support for the reform was also viewed as eroding, as the economic upturn following 1982 had failed to satisfy the population's need for more and better housing and higher levels of consumption. A common view among reform-oriented economists was that the arguments for various "temporary" administrative measures that tended to work against reform had been put forward by various groups within the administrative apparatus more as a defense of their traditional position than as a necessary response to the problems caused by continued market imbalances (Pajestka, et al (1986), Wilczyński (1988) and Życie gospodarcze (various issues)).

Many of the criticisms of the state of reform at this time hearkened back to the discussions of the economic system in the late 1970s. In particular, stress was laid on the necessity of redefining the powers and further reducing the size of the central economic administration as a prerequisite for diminishing its role in economic life. Other criticisms related to the dominance in 1982-86 of macro or microeconomic policy concerns over those of reform. The principle of enterprise autonomy, for example, was viewed as having had little impact on the making of investment decisions that could have a major effect on economic structure. Some observers suggested that there had been little strategic rethinking of Poland's development strategy at the outset of the reform process; consequently, most investment continued to be undertaken in connection with large projects begun before 1982 which in many cases did not meet the efficiency criteria that were to inform the decisions of enterprises. In this and in other areas, there existed a fundamental inconsistency between the reform principles and the authorities' economic and development policies (Pajestka, et al. (1986)). An at least temporary weakening of reform orientation within some influential circles could be seen in the theses prepared for discussion at the Tenth Congress of the PUWP in July 1986, in which the need for a deepening of the reform process received little mention (Central Committee (1986)). The Congress resolved, however, that efforts should be made to reinvigorate the reform process, and the Sejm refused to approve in late 1986 changes in legislation proposed by the Government which would have reversed some of the earlier reform initiatives (Wilczyński (1988)).

In April 1987, a joint Party-Government commission on economic reform issued a draft set of theses calling for a "second stage" of economic reform. The declared objectives of the second stage were essentially the same as those of the 1981-82 reform blueprint: to increase economic efficiency and establish market balance. Many of the specific reform initiatives listed in the theses were reaffirmations of measures outlined in the earlier blueprint, but there were also new proposals. Publication of the theses was followed in October 1987 by the issuance by the Council of Ministers of a program for implementation of the second stage of reform, including a timetable for 129 "major actions" that were to be taken up to December 1991. Other tasks, such as the gradual reduction of detailed material planning in successive central annual plans, were to be carried out on a continuing basis. The program also contained a more detailed schedule of specific actions to be taken in various reform and economic policy areas, with the responsibility for these actions assigned to one or more ministries or agencies (Council of Ministers, (1987)); most of these measures were to be implemented within 1988. A revised version of this program was approved by the Sejm in early 1988.

In November 1987, a referendum was held on certain proposals of the Government in connection with this reform package, including a planned price-incomes operation in 1988 designed to improve the relative price structure, reduce subsidies, and bring the economy closer to equilibrium. In the event, less than half the electorate supported these proposals, but the authorities announced their intention to maintain the basic thrust of the reform program while proceeding with more modest increases in administered prices. The price-incomes policy introduced in early 1988 called for broadly a doubling of the rate of inflation and a further decline, after a 3 percent fall in 1987, of real wages in the socialized sector. The policy proved to be unacceptable to the population, and within 1988, in part as a result of two waves of labor unrest, a form of price-wage spiral developed that led to a 60 percent rate of inflation (year-on-year) and a growth in real incomes of the population of almost 15 percent. Real consumption growth of about 3 percent was insufficient to forestall growing excess demand pressures. In October 1988, a new Government was appointed which committed itself to bringing down the rate of inflation, reducing shortages, and accelerating the process of economic reform. 1/ A recommitment to broad, market-oriented reform was included in the political and economic agreements arrived at during the social "round-table" discussions carried out in March-April 1989.

IV. *Reform of the System of Microeconomic Decision Making*

1. 1981-86

a. Enterprise autonomy

The first step in reform implementation in this area involved a reorganization of the economic administration at the government level in July 1981. At that time, the 11 branch ministries for industry were consolidated into six ministries--comprising mining and energy, metallurgy and machinery, chemicals and light industry, construction, agriculture and food industry, and forestry and wood products.

In September 1981 two basic laws were passed that respectively established the basis for enterprise autonomy and self-management through workers' councils. 2/ According to the legislation dealing with enterprise autonomy, state-owned firms were now to have the right to set their own production targets, make their own investment decisions, determine their sources of supply and decide their level of employment. Supervision of state enterprises was to remain with their so-called founding organs, usually the ministry or local authority that had previously supervised them. Governmental limitations on enterprise autonomy were to be permitted "only in cases provided by legal regulations." The initial legislation, however, provided that this legal guarantee of autonomy would not apply to state enterprises engaged in defense contracting, to public utilities or to financial institutions. Moreover, the founding body of the state enterprise retained its ability to assign tasks to the firm if they were considered to be indispensable for the national defense, in the event of a natural disaster or

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1/ In May 1988 the former government had been granted by the Sejm so-called extraordinary powers designed to permit the authorities to deal with the growing financial imbalances and to speed up the implementation of the reform.

2/ A collection of the legislation and legal regulations governing the reform process since 1981 is contained in Pietrkiewcz and Libera (1987) and Libera (1988).

in order to fulfill international commitments (i.e., obligations to other CMEA members). In general, enterprises were to have the right to conduct their activities on the basis of their own plans, but the compatibility of their plans with the goals of the central plan would be attained by means of various economic instruments as well as, in the above cases, assignment of tasks (Polish Chamber (1982)).

The role of central planning and of the Planning Commission in the implementing legislation of February 1982 was somewhat more ambiguous than had been stipulated in the reform program adopted by the PUWP in July 1981. In contrast to the role of a "staff organ of the government not undertaking operating decisions," (program) the law on planning appeared to give a more assertive role to the planning commission. The *functioning and development of the economy* were to be "regulated by the system of socioeconomic plans which actively shape economic development with the help of market mechanisms". The Council of Ministers would organize the implementation of plan tasks and would take decisions necessary to attaining plan targets. The Planning Commission was designated as the chief body of the state administration concerned with social-economic planning. The branch departments of the planning commission were maintained, to enable active coordination with the branch ministries with respect to plan implementation (Plowiec (1986)).

With a view to ensuring adequate production of certain essential items in a period of severe disequilibrium, the authorities in practice either instructed enterprises (under operational programs, beginning in 1982) or invited them to submit bids (under government contracts, starting in 1983) to carry out certain tasks while assuring them the necessary access to inputs and foreign exchange. With respect to government orders, a special commission decided each competition for a contract. The commission would be appointed by the founding body for the "ordering" enterprise, and would be chaired by a representative of this body. The commission would include representatives of the Planning Commission and several other functional ministries or agencies, as well as the ordering enterprise. A large bureaucracy was therefore involved, and the bidding process apparently could be easily manipulated by individual branch ministries (Smuga (1987)).

In 1982 there were 16 operational programs, encompassing 60 percent of industrial production, but their number was reduced to 6 in 1983 and 3 by 1986. The decline in importance of these programs, however, was partly offset by the increased issuance of government orders, which encompassed 30 basic materials and 10 central investment projects in 1983, but had grown by 1986 to cover 106 products and materials, 76 central investment projects, and some important areas of research and development (Plowiec (1988)). In 1986 almost 20 percent of the value of material supplies was still centrally allocated to producers under operational programs and government orders (1984: 40 percent (Plowiec (1988)).

Although, after mid-1982, enterprises were in general no longer required to belong to industrial associations at the intermediate level, the legislation of September 1981 provided that "when it is socially and economically indispensable they could be obliged by the Government to join such organizations, up to a period of five years." 1/ Enterprises were also permitted to join voluntarily such associations, which are thought to have played an important role in helping their members secure supplies in a situation of continued market imbalances. These voluntary associations were estimated to have included in 1982 about half of the enterprises that had earlier belonged to the former obligatory associations. In 1984 there were 162 associations, of which 36 were obligatory (Plowiec (1988)).

This continued close involvement by the central and intermediate levels in the everyday activities of enterprises was considered by many as absolutely essential in light of continued severe market imbalances and the need for the authorities to ensure both minimal availability of key final products as well as a certain growth in convertible currency exports so as partially to meet debt service and pay for imports of crucial inputs, spare parts and consumer goods. Prior to 1982, all basic inputs had been centrally allocated by branch ministries to industrial associations, which in turn distributed them among individual enterprises. Following the introduction of reforms in 1982, central material balances continued to be prepared by the Planning Commission and the Ministry for Materials and Fuels Economy. Whether a centrally balanced commodity was also centrally allocated depended, however, on the severity of shortage of the product and its perceived significance as an input or export. In 1982 about 70 percent of the value of material inputs was centrally allocated. Legislation enacted in February 1982 intended that administrative allocation of materials and fuels be terminated at the end of 1983. In December 1983, however, the system of central rationing was extended indefinitely, although with the proviso that each year the Government would have to present to the parliament a program for reducing its scope.

In 1984 about 60 percent of the value of basic material inputs was still centrally rationed, but changes were made in the allocation system with the allocation of inputs being shifted from an enterprise basis to a sectoral basis, and for most inputs the process was delegated to 28 so-called obligatory state trading organizations, each of which was assigned a specific commodity group.

Some centrally allocated materials, energy products and agricultural inputs were distributed through separate systems. Agricultural inputs were allocated either through government purchasing centers in return for farm produce sold to the state, or on a regional basis and distributed by local government agencies or sold freely on a first-come,

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1/ In 1982 some 400 obligatory associations of enterprises were abolished (Plowiec (1988)).

first-served basis. Individual energy products were allocated by separate central agencies according to guidelines laid down by the authorities. At the retail level, energy products were distributed at the regional level by a network of wholesalers. Separate trading organizations also existed for the central allocation of construction, agricultural and transportation equipment. Inputs not centrally allocated were handled by more than 100 trading organizations that dealt exclusively in intermediate products. Although these organizations were typically specialized, a purchasing enterprise could sometimes choose between them.

Some 85-90 percent of retail trade in the socialized sector was carried out by three large trading organizations. Two rationing systems existed at the retail level: one involved distributing products geographically through the local governments, which in turn allocated these products to the trading organizations; the other consisted of limiting individual consumption by a card system. In 1982, ration cards covered 23 product groups, but by 1986 the number of groups so rationed had been reduced to four.

By 1986 the scope of central allocation of material inputs had been reduced to 45 percent of the value of these supplies, of which somewhat less than one half was allocated for fulfillment of operational programs and government orders. 1/

b. Property rights--workers' self-management

The 1981 reform program stipulated that workers' councils and the work force at large were to play an important role in the running of enterprises, notably in the appointment of managers and in the adoption of plans. Enabling legislation in this respect was adopted in September 1981. In enterprises with less than 300 employees the entire work force was to decide the fundamental issues facing the firm, at a general meeting. In enterprises employing more than 300, these issues would be decided by a meeting of workers' delegates elected by secret ballot. Issues to be decided would include adoption of the enterprise's statute, the distribution of profit, evaluation of the director and of the workers' council and approval of the long-term plans of the enterprise. Crucial management decisions of the enterprise, ranging from investment, enterprise-sponsored housing and the production profile of the firm, would be decided by a 15-member workers' council, elected for a two-year period as the organ of self-management (Polish Chamber (1982)).

During the discussion of alternative reform proposals, considerable controversy had arisen regarding the issue of appointment of enterprise

1/ Given that most of all of the centrally allocated products were in excess demand at prevailing prices, such percentages of course understate the incidence of central allocation.

directors. The compromise solution adopted in the legislation provided that in the 1,400 enterprises of "basic significance for the country," such as railroads, airlines, and a large number of industrial enterprises, the director would be appointed by the founding body, representing the state. In other enterprises, which constituted the majority, the director was to be appointed, on a competitive basis, by the workers' council. Both the founding body and the workers' council had the right, in the respective groups of enterprises, to "launch a justified protest" against decisions to appoint or recall a director, and continued disagreement between the parties be settled by the courts (Polish Chamber (1982)). In public utilities, the defense industry, banks, and other enterprises subject to special regulations, however, the workers' council had no rights regarding personnel decisions (Mujzel (1988)).

In the event, the self-management provisions were suspended upon imposition of martial law in December 1981. By the time martial law was lifted in July 1983, however, workers' councils had been established or reinstated in about 6,000 enterprises (Fallenbuchl (1986)), and by the end of 1984 councils were operating in 87 percent of those firms entitled to them (Plowiec (1988)). Nevertheless, in these enterprises the workers' council did not constitute a majority of the committee that organized the recruitment competition and it has been observed that the PUWP and governmental authorities continued to dominate the recruitment and appointment process. In the view of some, the traditional nomenklatura system continued to prevail in major personnel decisions within state enterprises (Mujzel (1988)). During the first period of reform little other experimentation was undertaken with respect to the issue of the property rights in state enterprises.

c. Financial discipline and incentives

The corollary of the intended increase in the autonomy of enterprises was that they would receive less financial support from the authorities and, more fundamentally, would be increasingly subjected to financial discipline. It was expected that profitability should become the major success criterion of state enterprises, inducing their management to become more competitive, improve quality and increase efficiency. The legislation of 1981 establishing the basis for enterprise autonomy and self-financing provided for the possibility of liquidation of state enterprises, but the criteria for such an action were left to be spelled out in later decrees and legislation. A law on bankruptcy was passed in late 1983 which provided for a lengthy, three-stage process in dealing with enterprises with chronic financial problems. In 1986, some 300 state enterprises and about 700 cooperatives (out of a total of some 16,000 socialized firms receiving bank financing) were deemed to have lost their creditworthiness and were being investigated under one of the stages of this legislation. By the end of 1986, however, only 11 state enterprises (although a considerably larger number of cooperatives) had been liquidated, typically through merging or restructuring rather than by being declared bankrupt in the sense of having their assets sold and the proceeds distributed among their creditors. It was also believed that many unprofitable enterprises in this period were effectively subsidized within the framework of the associations to which they belonged, thereby avoiding liquidation proceedings (Fallenbuchl (1986), Plowiec (1988)).

According to the reform blueprint, enterprises were to be subjected increasingly to financial discipline both by the budget and the banking system. 1/ A more general factor determining the degree of financial discipline faced by an enterprise was the degree to which it retained the possibility of bargaining with and/or enlisting the financial or other support of central and local authorities. Therefore, in addition to special treatment from the fiscal and monetary authorities, an enterprise might improve its financial results by receiving preferential allocation of scarce inputs or favorable treatment from the price or wage authorities (see Sections V and VII), or by receiving other forms of preferences. Given the continued, although probably diminished, pervasive intervention by the authorities in the affairs of most state enterprises in this period, the opportunities for such preferential treatment were no doubt considerable.

d. Promotion of competition and the private sector

The legislation of September 1981 providing for enterprise autonomy also permitted a state enterprise to undertake activities in fields not stipulated in its founding statute. If changing its production profile were to involve giving up or markedly decreasing production in areas provided for in its statute, however, the enterprise would have to seek advance consent for the change from its founding body. Given the macroeconomic environment of extreme shortages in the first years of the reform, neither enterprises nor their founding organs had much interest in, or scope for, expanding or changing their production profiles.

Although progressive demonopolization of the economy was a principle of the reform blueprint, few tangible measures were taken in the early years of the reform to reduce the degree of concentration in industry. The shortage situation, maintenance of a branch administrative structure, and the proliferation of operational programs and government orders tended to reinforce the high degree of monopolization. 2/ Some measures aimed at increasing competition in the foreign trade sector, however, were taken (see Section VI).

The reform program considered that broader opportunities for smaller producers would be an important factor in stimulating initiative and competition in production (Sadowski (1982)). Competition in

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1/ Developments in these two areas are discussed in Sections VIII and IX.

2/ Plowiec (1986) observed that through the end of 1985 successive versions of a draft antimonopoly law had been progressively weakened.

services and other branches of the small-scale economy was increased somewhat in the early reform period through various measures aimed at liberalizing restrictions on private activities. These included relaxation of administrative practices affecting trading links and price regulation, and private firms also attained improved access to inputs produced in and to the markets of the socialized sector. In a decree issued in June 1981 the Council of Ministers announced the equal treatment of handicrafts and other small-scale activities. Legislation was also passed in July 1982 that significantly eased the conditions for establishing foreign-owned small-scale industrial operations in Poland, the so-called "Polonia" firms. Such ventures, which were explicitly aimed at rapidly increasing domestic supplies in the shortage environment, could be fully foreign-owned and were not required to include Polish citizens in their management. Their number increased from 18 in 1978 to 232 in 1982 and 799 in 1988. 1/

At the same time, however, the private nonagricultural sector was also subjected to various restrictive measures. For example, legislation aimed at speculation was passed in September 1981 and subsequently amended and strengthened in 1982-83. This law established a new governmental control apparatus, a large part of which was focused on private sector activities. Such measures were accompanied by increasing public pronouncements by the authorities criticizing the private sector for alleged economic crimes and speculation. There was increasing regulation of private leaseholders, and tax legislation was passed that was intended to reduce tax preferences accorded to private activities, including the Polonian enterprises (Aslund (1985)).

2. The second stage of reform

a. Enterprise autonomy

The 1987 program for implementation of the second stage of reform placed considerable emphasis on the need to strengthen enterprise autonomy and self-management. At the same time, the program reaffirmed that "the fundamental role for steering economic processes is to be played by the state, the organs of which would be assured a broad range of means for influencing these processes, particularly through economic instruments, but also with the possibility of supplemental application of administrative means" (Council of Ministers (1987)).

The program provided for a "transformation" of central planning, with the central annual plan to be developed as an integrated financial-material plan, beginning with the annual plan for 1989 (Misiag (1988)). There was also to be a gradual reduction in the scope of detailed substantive planning, as well as of government orders, and

1/ Some of these firms were quite large by the standards of the small-scale economy. In 1983-84 at least 20 Polonian enterprises had more than 300 employees (Aslund (1985)).

remaining operational programs were to be eliminated by the end of 1988. The scope of central allocation of material inputs was also to be reduced.

After the change in government in late 1988, legislation was passed transforming the Planning Commission into a new Central Planning Office (CUP). 1/ The CUP was intended to be a staff organ and was to be relieved of the function of the "current management of economic processes and of all types of reserves." In addition to elaborating draft 15-year perspective plans, five-year plans, the central annual plan and regional plans, it would also coordinate Poland's socioeconomic plans with other members of the CMEA. The central annual plan for 1989, which had actually been developed by the now-defunct Planning Commission was described by its authors as differing materially from the plans of earlier years in its significantly narrower range of specific physical indicators and the expansion of the financial part of the plan (Council of Ministers, 1988b). Annexes to the plan, however, still contained considerable detailed information on central material balances, central investments, the allocation of foreign exchange and lists of government orders.

With respect to priority programs, all but one operational program--covering the health care sector--had been abolished by 1988 and supplies covered under this program were to be delivered under government orders in 1989. The trend in government orders was more difficult to evaluate, although the authorities indicated that the value of production covered by government contracts was planned to fall in nominal terms by about 41 percent in 1989. 2/ Between 1984 and 1988 the proportion of material supplies (by value) allocated to producers under all such priority programs fell from about 40 percent to under 10 percent.

Although the share of material inputs subject to central balancing remained at about 60 percent in 1986-88, there were significant reductions in the scope of formal central allocation. The proportion (by value) of material inputs subject to central distribution fell from 45 percent in 1986 to 22 percent in 1988, and there was to be a further decline in 1989, when only hard coal and derivatives, coke, motor fuel,

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1/ This, incidentally, was the title of the planning agency that was superseded in 1948 by the State Commission for Economic Planning when the transformation of the Polish economy into a CPE was accelerated (Montias, 1962)).

2/ In 1988 these contracts appear to have accounted for less than 5 percent of gross output.

fuel oil, paper, personal automobiles and buses were to be formally centrally allocated. 1/ Informal rationing, however, must inevitably remain significant in a climate of widespread excess demand.

In late 1987, the central economic administration was streamlined, with employment at this level reportedly falling substantially in subsequent months. All industrial branch ministries other than those involved with hard coal and energy (and brown coal) were subsumed under a single Ministry of Industry; the coal and electric power industries were transformed into separate "communities." In January 1989 a governmental decree was to go into effect that would consolidate the eight existing coal companies into five companies organized on a geographic basis, leading to a loss of some 1,000 administrative jobs and meant to ease the introduction of a new economic financial system into the coal community. In October 1988, the Council of Ministers recommended the reduction of employment in eight specialized control agencies and obliged individual ministers to present proposals for reform of the system of control which would provide greater freedom and flexibility to individual enterprises. In 1988, there were no longer any obligatory associations of industrial enterprises, as their charters had all expired after five years. There still remained several score of voluntary associations, although they were said to be viewed as less popular than before because their members could no longer charge the financial burden of supporting these associations to their costs but only to after-tax profits. 2/

b. Property rights

Another change in the system of industrial administration in this period has involved the planned reduction of the number of state enterprises subject to direct supervision by a ministerial level, and their transfer to the supervision of local authorities. These transfers began early in 1988; it was intended that ultimately only 400 enterprises, deemed to be of "basic significance," would remain directly subordinate to the Ministry of Industry. 3/ Whether this decentralization of supervision over state enterprises would effectively increase their autonomy and financial discipline, however, remained an open question. The Ministry of Industry would still be responsible for general policies affecting all 3,000 state enterprises in industry, and a new Ministry for the Internal Market was given responsibility for

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1/ Formal rationing of gasoline and of coal at the retail level were terminated effective January 1, 1989. Administrative allocation of automobiles to individuals working in preferred sectors has also been abolished.

2/ In early 1988 there were 68 voluntary associations within the coal and energy communities alone.

3/ As of mid-1988 some 1,000 enterprises were still so considered.

supervising the retail market and the system of central allocation. The Ministry of Industry also rations some products and now has the responsibility for setting norms for materials and energy consumption.

The implementation program for the second stage also stressed the importance of strengthening the role of employee self-management in state enterprises, and committed the authorities to "eliminate obstacles to the implementation of the statutory model of partner-like relations" among the management organs of enterprises The implementation of the principles of self-management within the enterprise was to be augmented through the further development of so-called work teams, the diffusion of self-management principles to the level of the individual factory, and increased scope for worker participation in the appointment of managers, including a limitation of the list of enterprises deemed to be of "basic significance" (Council of Ministers, 1987).

Few tangible actions in this area were actually scheduled in the implementation program, and it is difficult to evaluate what further progress might have been made toward strengthening workers' self-management in 1987-88. Possibly significant, however, was the continued proliferation of enterprise work teams in 1987-88 (see Section VII.2.) and the aforementioned reduction in the number of enterprises considered to be of basic significance to the national economy. Moreover, active consideration was being given within the highest circles in 1988 and 1989 to abolishing the "political criteria" for appointment to managerial posts, an exception being made for the appointment of directors of enterprises of basic significance.

The implementation program for the second stage called for a review of existing restrictions on the creation of new economic units by state enterprises, cooperatives, and private firms, as well as on economic activities by individuals. Relatively little attention was devoted, however, to the issue of ensuring that the owner of existing state enterprises would have above all an interest in their efficiency, and that their managers would share this interest.

Nonetheless, the Planning Commission published in February 1988 a "synthetic" system for evaluating enterprise performance which had been formulated over several years. Its main aim was to make more objective the evaluation of managers, and was considered by some to be a useful instrument during the period of transition of the second stage of reform, when due to distorted prices and still incomplete financial discipline, enterprise profitability alone could not be relied on as an adequate measure of performance. Some observers criticized the system for effectively perpetuating the multiple criterion approach of traditional central planning and as a mechanism by which the authorities could intrude on enterprise autonomy. The new approach did provide, however, that the remuneration of managers would be based on their firm's performance under this system, rather than on negotiation with the Council of Ministers (which had previously determined the salaries of enterprise directors) and their respective founding bodies (which set the bonuses of directors). Other observers suggested that this evaluation scheme was meant only to assist enterprises in evaluating their own performance and was not intended to be in any way binding.

In January 1989, legislation was passed establishing a basis for splitting the capital of each state enterprise into two parts, one to be owned by the state treasury and the other to remain as the enterprise's "own" property. The investment of the state treasury, to be known as the "founding body's fund," would be based on the value of the enterprise's capital as of the end of 1983. The enterprise would be required to pay an annual dividend on this investment, the rate of this dividend being set equal to the rate of interest on refinancing credits provided by the NBP. 1/ The size of the founding body's fund in an enterprise could increase over time to the extent that the firm were to continue to receive subsidies from the budget and its assets formally revalued. The enterprise's own capital would be augmented over time by, inter alia, its undistributed after-tax profits. This change in the financial system of state enterprises would be accompanied by a lowering of their statutory income tax rate (see Section VIII). At the same time that this legislation was introduced, the Government announced that in 1989-90 state enterprises would be permitted to deliver all or part of their property into agency or leasing arrangements, and that initiatives would be supported to transform these enterprises into joint stock companies with participation by individuals and legal entities as well as--with at least a 51 percent share--the state treasury (Council of Ministers (December 1988a)).

c. Financial discipline

Little explicit attention was given in the implementation program of the second stage to strengthening financial discipline from the side of the enterprise. Greater financial discipline, of course, was implicit in the reaffirmation of enterprise autonomy; to the extent that the bureaucratic hierarchy that facilitated bargaining over the hardness of the firm's budget constraint was dismantled, such bargaining would presumably be reduced. As noted in Section VIII, however, there is little evidence that enterprises were materially less successful in 1987-88 in negotiating fiscal exemptions than they were earlier, and the stepped-up scope for price monitoring in 1988 (see Section V.2) meant that prices effectively negotiated with the center were potentially even more numerous.

The procedures for liquidation of enterprises established under the Bankruptcy Law of 1983 continued to apply in this period. However, with the imposition of extraordinary powers in May 1988, the Council of Ministers issued warnings to some 1,000 enterprises which in its view

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1/ Certain enterprises, such as public utilities, would be assigned a lower dividend rate or be relieved of the obligation of paying a dividend.

either needed to undergo accelerated bankruptcy proceedings or required immediate measures to be taken to improve their low level of profitability. Under these powers the Council of Ministers also assumed the right to remove the directors of enterprises not of "basic significance" without having to achieve the agreement of their workers' councils as provided for in the 1981 law on self-management. Under the extraordinary powers some 140 enterprises were identified as possible candidates for liquidation; actual decisions to begin liquidation were taken in 1988 with respect to 33 enterprises, including the Lenin Shipyard in Gdánsk.

d. Promotion of competition and the private sector

The 1987 program for the implementation of the second stage of reform outlined a broad range of measures aimed at promoting competition. Affirming the principles of "what is not prohibited by the law is permitted" and "equality of treatment of all sectors," the program emphasized the need to encourage the establishment of new economic units, in all sectors, as well as the necessity to break up many of the existing monopolies and to ensure equal access of all economic units, regardless of sector, to supplies and investment resources. Expanded private activity was to be particularly encouraged in domestic trade, services and catering. 1/

In accordance with the antimonopoly law of 1987, an office for demonopolization was established in early 1988 within the Ministry of Finance. Its responsibilities included the formulation of antimonopolistic policies, investigation of complaints of monopolistic behavior, and the imposition of sanctions on enterprises found to engage in monopolistic practices. Under the extraordinary powers granted to the Council of Ministers in May 1988, it could take accelerated measures to break up monopolistic enterprises. In the course of 1988, almost 300 enterprises were split up under this authority. Toward the end of 1988, the Government issued a decree that ended the monopoly of state enterprises in procurement for food processing. This was intended to encourage private food processing and to stimulate competition in this sector more generally.

No major reform initiatives were enacted in the course of 1987-88 that would have affected private economic activity within that period. Nevertheless, the share of value added of recorded private activity in nonagricultural NMP continued to grow in this period--in current prices

1/ Also see Section VI for measures taken to increase competition in foreign trade.

this share reached 10.1 percent in 1987 1/ compared to 7.0 percent in 1980. For industry the analogous share rose from 3.6 percent in 1980 to 7.3 percent in 1987 (Rocznik statystyczny, various issues).

After the change in Government in the autumn of 1988, the draft law on economic undertakings was liberalized, most notably in the elimination of any ceiling on the number of employees permitted in a private enterprise, and enacted by the Sejm in December. Henceforth, the undertaking of economic activities would only necessitate registration with the local authorities but no consent, except in a limited number of areas specifically mentioned in the law as requiring so-called concessions. All enterprises, without exception, were to be taxed according to uniform principles, and to have equal access to bank credits and means of production regardless of their form of ownership.

In sum, the system of microeconomic decisionmaking in Poland appears to have undergone some significant changes since 1981. While enterprise "autonomy" is an empirically elusive concept, the role of the central planners in the planning and direction of everyday economic activities has clearly declined and a large share of state enterprises probably enjoys a greater degree of autonomy now than at the beginning of the decade. Moreover, there appears to be greater emphasis on profitability as an evaluative criterion for enterprise management than earlier. While official controls over inputs and other production remain, their scope has generally been reduced during this period. Enterprise autonomy, however, is still restricted in a de facto sense by remaining controls, informal rationing, and various constraints resulting from the CMEA trading mechanism.

There has been less evidence of a tightening of enterprise financial discipline; indeed, the plane for bargaining has tended to shift mainly to negotiations over financial regulations. It is possible, however, that the relatively recent final step in the elimination of the industrial branch ministries may strengthen the hand of the central authorities in these negotiations, in that enterprises must now bargain individually with the center. Moreover, more attention is now being given than ever before to improving and actually utilizing established procedures for the liquidation of enterprises.

Recent steps to increase the autonomy of enterprises have coincided with a renewed emphasis on strengthening the actual decisionmaking role of workers councils in state enterprises. At the same time, there have been recent moves toward transforming the property rights of the state administration into a more passive ownership position, and initiatives have been undertaken to open up the way for conversion of state enterprises into joint stock companies with possible participation by

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1/ The actual share of personal incomes earned from private nonagricultural activities is likely to be somewhat larger (Rostowski (1989)).

private investors. It is unclear how these different developments regarding property rights in state enterprises will be reconciled in coming years.

The degree of concentration and competition within the Polish economy appears to have changed only slightly during the reform period 1981-88. The new law on economic undertakings, however, together with a more determined approach to demonopolization and increased emphasis on foreign competition, including through the liberalization of restrictions on joint ventures, could provide the basis for a more significant increase in domestic competitive pressures in the 1990s. Private activity continues to increase as a proportion of total nonagricultural output, and the new law on economic undertakings, if rigorously applied in the spirit of "what is not prohibited by the law is permitted" and "equality of treatment of all sectors," should lead to substantially increased competition from the private sector.

V. Price Reform

Changes in the price system were a central element of the reform program of 1981-82. A law on prices enacted in January 1982 established three price categories: administrative, regulated and contract prices. Administrative prices were to be set by the Government in a manner similar to that which existed for most products before 1982. These prices were to apply to four types of products: (1) consumer goods and services that were of basic importance in daily consumption, a large share of which was and continues to be heavily subsidized; (2) basic intermediate goods; (3) basic agricultural produce purchased by the socialized sector; and (4) alcoholic beverages, tobacco products, and postal and telecommunication services.

Regulated prices were set by producers on the basis of costs and would be closely monitored by the authorities. From the beginning, however, this system of price determination was considered a transitional stage in between administrative and contract pricing.

Contract prices were, in principle, to be set freely in the market place. This price category was of course fully consistent, in principle, with the formal legislative provisions for expanded enterprise autonomy. Although the scope for control was to be sharply curtailed, the State Price Commission, which had both price-setting and monitoring responsibilities, was in principle to achieve enhanced authority as a functional agency because it would now be dealing with thousands of independent enterprises rather than with a small number of branch ministries and the industrial associations (Gomulka and Rostowski (1984)). This functional responsibility was assumed in 1985 by the Ministry of Finance.

The reform in the price system in 1982 was accompanied by a more than doubling of administered retail prices and in many cases even larger increases in the administered prices of producer goods. Other prices grew apace, and as a whole retail prices increased on average by 100 percent and producer prices by 120 percent, year-on-year, in 1982. In 1982, contract prices applied to 50 percent of retail turnover (food: 34 percent), 75 percent of procurement of material inputs, 60 percent of producer prices of manufactured goods, and 35 percent of agricultural procurement.

While substantially reducing the degree of disequilibrium and restoring the financing health of the enterprise sector as a whole, the massive price increases of 1982 were evidently not sufficient to bring most markets into equilibrium. With the intent of significantly lowering the rate of open inflation in the economy in 1983, the Council of Ministers introduced in April a price freeze on all producer prices for a three-month period. A further decree in July 1983 limited contract price rises on producer goods to those resulting from increases in so-called justified costs, defined essentially as those beyond the control of enterprises. 1/ This limitation on enterprise autonomy in setting contract prices was accompanied in 1983 by reductions in the scope of contract pricing for all main product categories, ranging from 5 percent for producer prices of manufactured goods to 20 percent for procurement prices for basic inputs.

In 1984 the scope of contract pricing was raised for all main product categories except agricultural procurement. Nonetheless, the prohibition on contract price rises--except to pass on justified cost increases--was extended to retail products, although with some exceptions such increases were permitted up to a ceiling of 10 percent. There was little change in the coverage of the different price categories or in the price control regulations in 1985, except that the pass-through of justified costs into producer prices was now limited to 90-95 percent in order to encourage enterprises to reduce the materials- and energy-intensity of their production.

In 1986, three additional approaches to regulation of contract prices for manufactured products at the retail level were introduced, each intended as a slight liberalization step: (i) average ceilings on price increases for different groups of products, varying from 8 percent to 25 percent; (ii) advanced notification of intended price increases to the Ministry of Finance, which had the possibility of postponing "justified" price increases for up to three months; and (iii) agreements between the Ministry of Finance and individual enterprises whereby the latter retained their freedom to set prices on specific above-standard products provided they maintained the share of such goods in their overall production. Certain retail products also continued to be subject to the 10 percent ceiling approach, initiated in 1984, but now the ceiling was applied to the average price of specific groups of goods

1/ Such costs included, for example, the higher costs of material inputs but excluded, in principle, increases in wage payments.

rather than to each product price. Also introduced in 1986 was a broadening in the scope for taxes on excessive price increases. In addition to being imposed for exceeding price ceilings or, in the case of producers prices, for passing through unjustified cost increases, the tax could now be levied when a producer's price diverged by more than a specified amount from the price of the identical or similar product of another producer.

In 1986, 4.1 percent of nonfood deliveries at the retail level sold at contract prices were subject to the justified cost/10 percent ceiling rule, 15.6 percent were covered by the 8-25 percent ceiling approach, 5.2 percent of deliveries were subject to advanced notification of price increases, and 1.4 percent were covered under the agreements between individual enterprises and the Ministry of Finance (Hajkiewicz (1988)). Consequently, roughly three quarters of retail contract prices for nonfoodstuffs were (implicitly) freely set. In 1986, all retail contract prices for food and services were in principle set freely by the market, which further implied that about 45 percent of all retail prices were free. In 1986 virtually all contract prices for producer goods were subject to the justified cost rule.

Price formation and the system of price control in the period 1982-86 was somewhat more complex than even the foregoing description suggests. There was considerable discretionary application of the rules governing contract prices, as the price authorities considered it necessary to promote the production of various high priority products, and in some cases to take into account sizable perceived differences in the degree of excess demand for different products. Particularly under the justified cost rule, producers were thought to have ample scope for introducing "new," more expensive products that did not, however, always involve actual higher costs (Hajkiewicz (1988)). Some enterprises also found that they could persuade the price authorities to accept as "justified" cost increases that portion of the increase in their wage bills corresponding to the increase in the overall price level, given that a given real wage growth target was incorporated in the central annual plan (Skrzypczak (1987)).

Beginning in 1986 the existing system for control of contract prices for producer goods, which consisted of permitting price rises only to the extent that they reflected exogenous increases in costs, was supplemented for some products with a 10 percent ceiling on such price rises. This ceiling approach was more widely applied in 1987. At the retail level, however, this justified cost/10 percent ceilings approach was eliminated. Retail contract prices in 1987 were therefore only subject to three control regimes: average price increase ceilings for different groups of products, advance notification, and special agreements with the Ministry of Finance. Roughly one-half of all retail prices continued to be free.

The price-incomes operation of 1988 described in Section III was accompanied by the abandonment of regulated prices on the 2-3 percent of products to which they had still applied and the shift of these goods to contract pricing. It was also accompanied, however, by a significant broadening of the scope for advanced notification of contract price increases for consumer goods. In early 1988, at the retail level, only one-third of all contract prices were still freely determined, 7-8 percent were subject to ceilings on price increases, and some 60 percent were subject to the advance notification procedure. This meant that only about 18 percent of all retail prices were free. In mid-1988, additional producer and consumer good prices were shifted from the administrative to the contract pricing category, and for the year on average only 16 percent of producer prices on industrial goods, 13 percent of industrial input prices, and 36 percent of retail prices (44 percent of food prices) were still administered. The proportion of administered agricultural procurement prices remained, however, at about 70 percent.

At the outset of the price-incomes operation, the authorities had established a reference limit of 30-35 percent for prices subject to advanced notification. Intended price increases above this range would be closely scrutinized by the local revenue offices of the Ministry of Finance, to which advanced notification was made. These offices could postpone approval of the price increases for three months, or could refuse to approve them and impose fines on enterprises that did not comply with their rulings or failed to give advanced notification in the first place. Under the extraordinary powers imposed in May 1988, the period for allowable postponement of approval of an intended price increase was lengthened in mid-year to six months. The 30-35 percent reference limit was later abolished when enterprises were permitted to pass on 96 percent of the increase in costs arising from a second (and unplanned) upward revision of administered producer prices for energy carriers and freight tariffs in August 1988.

Certain modifications to the Law on Prices in May 1988 were designed to provide the basis for greater flexibility in the process of price liberalization. Rather than specific products being mentioned in the law as having administered prices, the law now simply noted that "certain products" would be subject to these prices. The Council of Ministers rather than the Sejm now determined which products were to be subsidized, and provision was made to allow the transfer of certain subsidized products from the administered to the contract price category, this being intended to ease the transition toward a more uniform and parametric form of subsidization. The category of regulated prices was maintained, but was to be used mainly as a sanction against enterprises that did not comply with the advance notification requirements for certain contract prices.

The proportion of administered prices was planned by the authorities to decline further for retail products to a little above 30 percent in 1989 (food: 42 percent). The scope of advance notification of increases in contract prices was to be drastically reduced to only 7 percent of all retail prices. Retail products with price ceilings and those with free prices were both to account for about 30 percent of all retail prices. The share of administered producer prices was also to fall slightly in 1989, to 14 percent and 11 percent for manufactures and inputs, respectively. The control of contract prices was to be changed, however, from the general prohibition on price rises, which effectively had meant that price increases were dependent on those cost increases due to factors exogenous to the firm, to what the authorities considered to be a more flexible ceiling approach. In principle, transaction prices were now to serve as the benchmark for allowable domestic contract price increases on goods that enter into foreign trade. For other goods, the increase in the average branch cost of production would be the reference point for establishing price ceilings; this was intended to favor the more efficient and cost-minded producers. 1/ In early 1989, all official agricultural procurement price ceilings were removed as part of an intended "marketization" program for agriculture.

The authorities also indicated their intention to monitor more closely the practice of price differentiation--with certain sanctions being applied in the more egregious cases--as well as the pricing behavior of oligopolistic firms that were believed to charge significantly higher prices than their competitors.

In sum, since 1982 the authorities have maintained a continuing commitment to administered price revisions with particular emphasis being placed on the relative prices of key energy and material inputs. The revision of retail prices has also been a continuing priority, both with a view to reducing subsidies and ameliorating market imbalances. The authorities' success with respect to these objectives, however has at best been mixed. Reform of the price system has also been a slow and highly complex process. At different times, the authorities have permitted various degrees of free pricing and utilized numerous combinations of price controls including administered prices, permitting contract price increases justified by the rise in stipulated types of costs, uniform price increase ceilings, special agreements between the authorities and enterprises regarding specific products, and obligatory advance notification of price increases. This constant tinkering with the system and changes in price categories cannot have contributed to a more stable regulatory environment for enterprises. Nevertheless, the scope for contract as opposed to administered prices has, since 1986, generally increased and, at the retail level, the share of free prices has once again been permitted to grow.

1/ This would appear to be an improvement over the previous system, in which all producers facing excess demand for their products could almost fully pass along increases in the prices of their material inputs and therefore had little incentive to economize on their use.

VI. Reform of the Foreign Trade and Exchange Rate Systems

1. The organization of foreign trade

One of the objectives of the 1981-82 reform was to break the traditional foreign trade monopoly of the FTOs. Prior to 1982, virtually all foreign trade activity had been carried out by about 60 specialized FTOs. Under the reform, producing enterprises were no longer to be arbitrarily assigned to a particular FTO (Plowiec (1988)). In addition, legislation of February 1982 provided that legal entities or individuals holding licenses to undertake production, service or trade operations could also receive foreign trade rights. These were specific licenses in the sense that they could be awarded for foreign trade operations involving only particular goods, markets, or contracts. Such licenses could be granted for either a limited or unlimited period. Licenses would not be granted, however, for trade in goods considered to be of "basic importance to the national economy." To qualify for a foreign trade license, an entity had to export at least 25 percent of its production or export in excess of Zl 1.0 million annually, and to demonstrate that it had adequate staff, organizational and technical capabilities (Polish Chamber (1982)). In the period 1982-84 almost 200 specific licenses were awarded on the basis of this legislation, but by 1984 the newly licensed units accounted for only 6.8 percent of total exports and 2.5 percent of imports (Plowiec (1988)).

Under the reform the FTOs were also to have greater autonomy than before in formulating and executing their foreign trade plans. In practice, this autonomy was somewhat restricted by the degree of detail regarding foreign trade which continued to be embodied in the central annual plan, the continued assignment of obligatory tasks to the FTOs, and the close supervision of the FTOs by the Ministry of Foreign Trade (World Economy Research Institute (1988)). Moreover, the system of central allocation was primarily aimed at ensuring an adequate supply of basic materials to the domestic market. As a result, exporters requiring such inputs were in general subject to formal or informal rationing of these goods, and exporters desiring to export materials directly were subjected to a form of export control. In some cases, on the other hand, the system of administrative allocation could be used to give priority to exporting firms in the rationing of scarce inputs. In the period 1984-86, about 45 percent of the value of exports was still subject to central balancing (although not necessarily subject to central allocation).

A further continuing constraint on the autonomy of enterprises, including foreign trade enterprises, was the set of mechanisms guiding trade with other members of the CMEA. The reform program developed in 1980-81 provided no guidance for how this cumbersome system might be transformed so as not to impede the other facets of the program. Indeed, the autonomy of enterprises was still circumscribed by law in part because of the need for a founding organ to assign tasks to its subordinate enterprises in order to "fulfill international obligations" (Section IV.1.). This direct limitation on the autonomy of producing enterprises due to the assignment by the center of particular export tasks tended, however, to be concentrated on a subset of all those firms producing for export, given the high degree of specialization by payments area. Aside from such direct limitation of enterprise autonomy, however, the need to meet agreed governmental export targets to CMEA partners also inevitably affected the autonomy of virtually all enterprises by influencing the scope of central allocation of material inputs and of convertible currency, the latter for purposes of importing inputs for incorporation into exports to the ruble area.

Legislation enacted in 1982 provided the basis for the transformation of state-owned FTOs into joint-stock companies that could be owned by one or more industrial enterprises along with the state treasury, the latter being represented on the board of the FTO by the MFT and holding at least 51 percent of the shares. The intent was to promote closer contacts between producers and their foreign markets and to facilitate their adaptation to changes in world market conditions. By the end of 1984, 25 such joint-stock companies accounted for about 60 percent of Poland's foreign trade turnover (Plowiec (1988)).

In mid-1986 legislation was enacted providing for joint ventures between Polish enterprises and foreign partners in export-oriented activities, although domestic sales were also possible. Investments were to be permitted in all but a few sectors (defense, transport, security, publishing, and FTOs). Joint ventures were to enjoy preferential treatment with regard to both income tax rates and foreign exchange retention, and were to be given equal access, with state enterprises, to locally supplied materials and spare parts.

The implementation program for the second stage of the reform contained a long list of general reform initiatives aimed at developing a "pro-export" orientation and expanded economic cooperation with the rest of the world.

In 1987-88, the number of specific licenses to engage in foreign trade continued to increase, reflecting both a relaxation of the qualifying requirements (e.g., through lowering the required minimum share of exports in a firm's total production) and a more liberal interpretation of licensing policy. By May 1988, 1,007 economic units were authorized to engage in foreign trade, compared with 347 units at the end of 1986. Of the total, only 49 units were specialized FTOs with monopolies in particular products; 1/ 89 major producing or servicing

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1/ The Central Statistical Office reported, however, that 90 FTOs accounted for 91.5 percent of exports and 96.3 percent of imports in 1988 (Rzeczpospolita, January 27, 1989).

enterprises had foreign trade rights. Some observers suggested that domestic firms continued to gain broadened autonomy in selecting their intermediary organization in foreign trade (World Economy Research Institute (1988)).

Effective July 1, 1988 a category of general licenses was created, which would include all import and export turnover other than special transactions and those concluded under bilateral agreements, leasing, and cases of outright denial of general licenses. It was anticipated by the authorities at the time that about 80 percent of foreign trade turnover would be eligible for general licenses, which were to be issued by the Ministry of Foreign Economic Cooperation (MFER) 1/ or by those FTOs to which the MFER had delegated authority. 2/

The system of central balancing and particularly of central allocation continued to impinge on the effective autonomy of FTOs and other economic units involved in foreign trade. In 1987-88, however, there was as noted in Section IV a significant reduction in the share of material inputs, both by number and value, subject to central allocation in the economy in general. While information is not available on the proportion of foreign trade that is directly subject to central allocation, the share of exports that was centrally balanced declined slightly to 44 percent in 1987. In late 1988, formal export quotas were applied to about 100 products that were centrally balanced; additional exports could also be designated by the Ministry of Industry as being subject to particularly severe domestic shortages. The share of imports subject to central balancing fell to 34 percent in 1987 and was planned to fall further, to 29 percent, in 1988. The constraining effect of the CMEA trading mechanism on the autonomy of enterprises could have been little affected by the continuing domestic reforms in 1987-88 in the foreign trade sphere. The impact of the CMEA system, as well as the continuing lack of specialization in the development strategies of its member countries, remained an important barrier to enhanced coherence of the Polish reform and economic policy (Expert Group (1987)).

In December 1988 a new law on joint ventures with foreign participation was passed which was designed to make such arrangements more attractive to foreign investors than under the 1986 legislation, and to place all such ventures, including existing Polonian enterprises, on an equal footing. The new legislation provided that foreign ownership could be as great as 100 percent, and that the director of the enterprise need not be a Polish citizen. The income tax rate for such ventures was to be equivalent to the new rate for all domestic firms, although temporary exemptions and reliefs for export activities would be

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1/ Established in late 1987 as the successor to the Ministry of Foreign Trade.

2/ For a more detailed description of the new licensing system, see "Polish People's Republic - Recent Economic Developments," SM/88/184 (8/18/88).

permitted. These companies would have full freedom with respect to employment and employee remuneration, and freedom of repatriation of foreign currency profits above and beyond the obligation to sell 15 percent of export proceeds to the banking system. The Government's consolidation plan for 1989-90 also affirmed its intention to reduce by one-half the ownership share of the state treasury in FTOs reorganized on a joint stock basis (Council of Ministers (1988a)).

In sum, the period since 1981 has witnessed an increase in the degree of competition among foreign trade organizations (FTOs) and broadened access of other economic units to direct participation in foreign trade. FTOs still account, however, for over 90 percent of Polish trade. De facto enterprise autonomy is still limited in foreign trade by the formal and informal rationing of inputs, export quotas, and certain facets of the CMEA trading mechanism. Fewer such constraints may now be binding, however, than in the early 1980s. The new law on joint ventures with foreign participation, enacted in late 1988, may provide a new impetus both to increased competition in foreign trade and lessened insulation of the Polish economy from world markets.

2. The exchange rate system, export incentives, and allocation of foreign exchange

a. 1982-86

In January 1982 a new exchange rate system was introduced. The separate deviza and internal exchange rates were folded into uniform exchange rates, one for the convertible currency area 1/ and one for trade with the ruble area. While the new exchange rate for convertible currency trade also applied to noncommercial transactions, the new rate for the transferable ruble (TR) applied only to commercial transactions. Separate rates for noncommercial purposes continued to be negotiated bilaterally with other CMEA members.

The new exchange rate for trade with the convertible currency area was to be the basis for calculation of so-called transaction prices, a price category actually introduced, on a limited basis, in the early 1970s (see Section II.2). Transaction prices were to influence freely set contract prices in domestic trade, and were to be a benchmark for the establishment of both administered and regulated prices for traded inputs on the domestic market. The exchange rates applied in both

1/ The exchange rate for individual convertible currencies is determined on the basis of their market exchange rates relative to a numeraire based on a weighted basket of such currencies.

convertible currency and TR trade were intended to be submarginal rates in the sense of ensuring the profitability of 75 percent to 85 percent of exports (Plowiec (1988)). 1/

Coincident with the introduction of the new exchange rate, the zloty was effectively depreciated by over one-half with respect to both the U.S. dollar and the TR. 2/ This depreciation was insufficient to keep pace with the sharp rise in domestic prices, however, and in the early years of the reform the convertible currency exchange rate corresponded more closely to an average than to the intended submarginal rate (Plowiec (1988)).

Although transaction prices were accepted in principle, in practice the traditional system of price equalization continued to operate in much of Poland's foreign trade. Under this Equalization Settlements System (ESS), a subsidy (tax) was applied to (levied on) the transaction prices received by an exporter--or paid by an importer--in order to equalize that price with the price prevailing on the domestic market. The ESS applied to all products traded domestically at administrative prices and in some cases to products traded internally at contract prices. In 1985-86, ESS subsidies or taxes still applied to products making up about 40 percent of exports to nonsocialist countries and 15 percent of exports to socialist countries. In 1985, exporters received subsidies on this account equal to about 11 percent of the value of total exports. Some major exports were also subject to large ESS taxes. In the first half of 1986, for example, domestic prices for coal were some 30-40 percent below export prices to the convertible currency area. At the same time, import prices of products such as petroleum and basic metals exceeded domestic prices by some 50 percent and 35 percent, respectively.

With the exchange rate not considered to provide sufficient incentive for export growth, the authorities supplemented it with several systems of tax relief. Income tax relief was provided to enterprises producing for export, with higher rates of relief provided for exports of highly processed goods and for sales directed either to the convertible currency area or to the Soviet Union. Receipt of subsidies under

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1/ Profitability simply meant that the transaction or border price, in terms of zlotys, was equal to or greater than the domestic producer's price for a given product. World Economy Research Institute (1988) suggests that the submarginal concept was intended as only a temporary measure, in recognition of the belief that the economy could not afford either a higher exchange rate (presumably to avoid a higher rate of inflation) nor the immediate loss of 15 percent to 25 percent of its exports.

2/ The comparison is between the new commercial exchange rate and the product of the internal and external (or deviza) rates under the old system (see Wolf (1985)).

the ESS, however, would reduce the amount of income tax relief which could be claimed by an exporter. The rate schedule for such reliefs was usually revised annually.

Beginning in 1986, enterprises could also qualify for an exemption from the tax imposed on excessive wage increases (see Section VII), with the amount of exemption being related to the share of exports in their production and, like the income tax reliefs, to their degree of processing and geographical destination.

In the enabling legislation for the reform, it was provided that importers would be able to purchase convertible currency from the banking system at the new commercial exchange rate. Given the severe foreign currency constraint prevailing in the early period of reform, however, these rights could not be implemented (Plowiec (1988)). Instead, the authorities continued to draw up an annual foreign exchange allocation plan, within the framework of the import needs incorporated in the central annual plan. A large portion of the foreign exchange allocation was distributed to the ministries for further allocation to enterprises operating subject to operational programs or government contracts. The ministries also were allocated foreign exchange for their own needs, such as the financing of consumer good imports by the Ministry of Internal Trade.

Although the preponderant share of convertible currency remained centrally allocated, a foreign exchange retention quota system was established in 1982. Under this system a qualifying exporting enterprise was given priority (but not automatic) rights to purchase foreign exchange at the official exchange rate for production-related imports, either its own or those of its suppliers, up to an amount equal to a certain proportion of its convertible currency export revenues. Other firms were subject to standard retention rates differentiated according to enterprise group. Retention rates were normally determined on the basis of the import intensity of the production for export of the enterprise, although basic materials were usually not included in this calculation. The proportion of imports from the non-ruble area financed through these retention (or ROD) accounts increased from 3 percent in 1982 to 9 percent in 1983 (Józefiak (1986), 20 percent in 1984, 23 percent in 1985 and 26-28 percent in 1986-88. In 1986 the liquidity of the ROD system came under pressure, and the maximum purchase of foreign exchange in the second half of the year was limited to 60 percent of an enterprise's accumulated rights.

Beginning in the second-half of 1982, state enterprises not possessing ROD accounts and desiring to develop production facilities for nonluxury consumer goods or export were allowed to take part in convertible currency auctions organized by the Bank Handlowy. The conditions for participating in such auctions were financially relatively stringent, however, and despite some liberalization in these conditions in 1983 this auction system remained of only negligible importance in the allocation of foreign exchange during this period (Plowiec (1988)).

b. 1987-present

In April 1987, the method of establishing the exchange rate against the basket of convertible currencies was modified, with a view to reducing the need for large discrete changes, and the profitability target for both convertible currency and TR trade was decreed, by the Council of Ministers in March 1987, to be 80 percent. Otherwise, the exchange rate system remained unchanged.

Despite various price realignments undertaken in recent years, the linkage of domestic prices to international prices of raw materials and other inputs has remained, in general, incomplete. Although a basic policy aim is to bring domestic prices of tradables closer to their transaction prices in nonruble trade, the substantial real depreciation of the zloty through the middle of 1988, combined with relatively tight controls over most producer prices, perpetuated and in some cases widened the ratio of transaction prices to domestic prices. At the same time, however, and in line with propositions included in the implementation program for the second stage of reform, the scope for application of administrative prices to the actual settlement of foreign trade transactions was diminished. Effective May 1, 1988 settlements in nonagricultural trade were to be made at administrative prices for only four products. 1/ Payments for all other traded nonagricultural goods (including coal) were to be settled at transaction prices.

Although transaction prices were to be the predominant basis for settlement in exports, it was also considered necessary to preserve a measure of subsidization for previously subsidized exports while at the same time encouraging more efficient exports and pushing down the incidence of subsidies. Accordingly, ESS was modified in several respects. First, effective January 1, 1988, agricultural exports were in principle subjected to a flat rate subsidy of 20 percent (for nonruble exports) and 50 percent (for ruble exports). 2/ Second, with effect from July 1, 1988 the system of export subsidies for nonagricultural nonruble exports was simplified, with uniform subsidy rates for particular nonagricultural products groups exported to the nonruble area being set at between 5 percent and 25 percent; these rates were lowered to a range of zero percent to 15 percent in 1989. Producers of exportables not on the list of 31 product groups formally eligible for such subsidies, or of goods for which the published rates did not guarantee the profitability of their export, could nevertheless apply for individually tailored subsidy payments. A condition for receiving individualized subsidies, however, was that an enterprise present a

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1/ Crude petroleum, iron ore, cellulose, and leather.
2/ These rates were raised, however, in 1989.

program for the restructuring of its production and improvement of its efficiency. 1/ Exporters of nonagricultural products to the nonruble area receiving price equalization subsidies under the ESS continued to receive lower income tax reliefs and were also subjected to a small reduction in their ROD retention rates. The so-called "individual" system of subsidy payments was maintained for nonagricultural exports to the ruble area. In 1987, export subsidies (to both currency areas) amounted to 11 percent of total exports, down from 16 percent in 1986, but at the same proportion as in 1985.

Systemic as well as "individual" tax reliefs on account of exports continued to be an important supplementary export incentive to the exchange rate in 1987-88. Income tax relief rates were raised substantially in 1987, especially for highly processed products, and the procedures for adjusting the amount of relief for exports subject to the ESS were modified so as to provide greater relief to efficient exporters. Income tax reliefs related to exporting activity continued to grow in real terms and as a proportion of total income tax reliefs; in 1987 they accounted for 55 percent of total reliefs, up from 45 percent in 1986 and 36 percent in 1985. Reliefs to exporters from the PPWW tax on excessive wage increases also continued to be significant in 1987.

In 1988, export-related tax reliefs were restructured with the aim of simplifying the system and avoiding increases in reliefs that were not strictly linked to real export growth. Changes included delinking the size of income tax relief from exchange rate adjustments--exports were to be valued at the exchange rate at the beginning of the tax year rather than at the prevailing exchange rate as in the past. The maximum relief rate was reduced, and reliefs for incremental exports were eliminated as were adjustments meant to increase reliefs for the more profitable exporters. In May 1988 two amendments to this system were introduced under the extraordinary powers, to apply retroactively to the beginning of the year. One change effectively threatened an enterprise with a loss of eligibility for relief from the PPWW tax on account of exports if its pre-relief PPWW obligation exceeded 25 percent of its after-tax profits. The other amendment, imposed in response to growing imbalances on the domestic retail market, provided that with certain exceptions all export-related tax reliefs could be withdrawn if a firm's deliveries to the domestic market in 1988 fell below the 1987 level.

In response to complaints by the export sector, the link between income tax reliefs and the prevailing exchange rate was reinstated by the authorities in December 1988. In 1989, however, the authorities simplified the procedure for determining income tax reliefs on account of exports by simply establishing the effective income tax rate as an inverse function of the share of an enterprise's exports in its total

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1/ Export subsidization is being turned over by the state budget to the Export Development Fund, an extrabudgetary fund, in 1989.

sales. 1/ Systemic reliefs on account of exports were not to be allowed from the system of taxation of excess wages established for 1989 (see Section VIII).

In January 1987, the foreign exchange retention scheme was restructured with a view to enhancing confidence in the system after the restriction of ROD rights in the second half of 1986. Major changes included the granting of ownership rights to foreign exchange retained in interest-bearing accounts, and targeting for the first time the average retention rate. At the same time, however, retention rates were reduced by 20 percent across-the-board, and outstanding ROD entitlements as of January 1, 1987 were converted into certificates that could be used to finance imports--in specified annual installments--in the period 1987-95. Beginning in May 1987, funds held in ROD accounts could be offered for sale at bimonthly auctions arranged by the newly created state-owned Export Development Bank. These auctions remained closely controlled through 1988, however, with the effective exchange rate far below the free parallel market rate--although above the official rate--and the value of transactions being relatively negligible (see below).

In early 1988, the authorities announced their intention to introduce, by 1990, five commodity-specific uniform retention rates, ranging from 10 percent to 50 percent. 2/ These new rates would depend on the degree of processing of a firm's exports, instead of their degree of import intensity. The scope for the use of retained foreign exchange was also expanded in 1988. Many enterprises considered the ROD accounts to be a significant, and in some cases the most important, nonprice export incentive.

Beginning in 1989, exporting enterprises were permitted to transfer their foreign currency earnings directly to their bank accounts instead of having formally to exercise their right to buy back the foreign exchange within a stipulated period from the banking system to which it initially accrued. Enterprises would be obliged to sell a certain portion of these earnings to the banking system, with this portion simply reflecting their designated retention rate. Retained foreign currency could now be used to purchase either imports or so-called internal exports (domestic sales, by authorized organizations such as PEWEX, for convertible currencies), and limitations on the types of business expenses that could be paid from their ROD accounts were to be reduced. About 30 percent of nonruble imports were expected by the authorities to be financed from ROD accounts in 1989 (Council of Ministers (December 1988b)).

1/ An exporting enterprise would not be allowed, however, to have an effective income tax rate less than 10 percent.

2/ At the time there were some 1,000 different rates ranging from 3 percent to 100 percent. The new system was actually introduced on January 1, 1989.

A significant expansion in access by socialized enterprises to foreign exchange through auctions was created in 1988. The auctions of the Export Development Bank (EDB) remained fairly negligible in importance in 1988, 1/ but for 1989 the authorities planned that a significantly larger amount of foreign exchange be auctioned by the EDB, accounting for 8 percent (6 percent) of total planned nonruble (convertible currency) imports.

About US$200 million was directed in 1988 to so-called commodity-currency auctions organized by Bank Handlowy, in which importers could bid for foreign exchange to purchase limited amounts of products specified in the central annual plan. Access to these auctions was restricted to recipients of such commodities in 1988 through the central allocation system and the effective exchange rates were also heavily managed. The authorities announced that these auctions would be open to any economic unit in 1989 that would use the foreign exchange to import from a list of 52 specified commodities. There were to be no foreign exchange quotas for individual products, however, and the amount of foreign currency to be so allocated was to rise to roughly 20 percent (15 percent) of total planned nonruble (convertible currency) imports.

Some US$40 million of earnings from internal exports of PEWEX and other sales outlets were also earmarked for auction in 1988 to socialized domestic trade organizations having no direct access to foreign exchange. The first foreign currency auction for nonsocialized economic units was also organized by Bank PKO, S.A. in December 1988. In early 1989 legislation was enacted that legalized, as of March 15, 1989, a wide range of foreign exchange transactions among residents and liberalized domestic trading in foreign currencies, including the participation of privately-owned economic units in EDB auctions; this latter provision led to the early abandonment of the separate auction for private firms mentioned above. In the aggregate, noncentrally financed imports were planned by the authorities to account for 59 percent of nonruble imports in 1989 (Plan 1988: 38 percent; 1984: 30 percent).

A retention quota scheme for foreign exchange earnings in transferable rubles (ROR accounts) was introduced on an experimental basis in 1986 and extended in 1987; the amounts retained were used mainly for financing travel to and the purchase of professional literature from other CMEA members. An expanded ROR system was to be introduced in 1989, with a uniform retention rate. Funds in these accounts could be used as before, but also for the purchase of certain types of machinery

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1/ Estimated volume at these auctions in 1988 was US$86 million, or less than 1.5 percent of convertible currency imports.

and equipment from the ruble area and to buy convertible currency for imports deemed indispensable for the strengthening of production for export to the ruble area. 1/

The authorities planned to introduce a new system of tariffs, effective January 1, 1989, which would reduce the average tariff rate by one third. A new tariff law was also intended to be enacted by the end of 1989 which would remove the distinction, with respect to tariff treatment, between commercial and noncommercial imports.

To summarize, reforms of the exchange rate system and in the allocation of foreign exchange to enterprises constitute some of the most far-reaching changes in the Polish economic system since 1981. Although the official exchange rate continues to be set on a submarginal basis, and price equalization continues to be significant for some product groups, steps have been taken to tighten the relationship between border prices and domestic prices, to increase and make more uniform the retention by exporters of their export proceeds, and to expand access of other enterprises to foreign exchange, notably through several auction systems developed since 1987. Effective exchange rates in these auctions tend to differ significantly, however, both among the different auction markets and from the official exchange rate. The less than full effectiveness of the latter as an export incentive, at its existing level, is demonstrated by the continued use by the authorities of various other export incentives, including tax reliefs, subsidies and credit preferences.

VII. Reform of the Wage System and Labor Market Policies

1. The system of wage regulation

In implementing the reform program the authorities were faced with the issue of how to reconcile (1) the goal of expanded enterprise freedom to set wages and wage differentials, desirable from a motivational and productivity standpoint, with (2) the need to regulate this process in an environment in which (a) firms faced distorted prices (and thus distorted financial results), (b) enterprises might not be subject to financial discipline, (c) certain segments of society opposed a significant widening of wage differentials, and (d) enterprise employees might not be sufficiently motivated to care about the long-run financial viability of the firm and would be likely to press for short-run wage maximization. The basic solution adopted in the reform program was to give enterprises greater, although still restricted, autonomy in establishing their wage structures and greater freedom in determining their wage bills, but to seek to limit the growth of the wage bill through taxation of wage increases considered to be excessive.

1/ Heretofore all such convertible currency has been administratively allocated, in a discretionary manner.

The 1981-82 reform legislation gave state enterprises the freedom to establish their own basic wage grids within the bounds of both the minimum and maximum wage rates and the stipulated number of job classifications still set by the center, and in accordance with centrally established principles for job grading. While premia payments guaranteed by legislation (e.g., seniority benefits, severance payments) continued to be based on centrally established formulae, enterprises were now given complete autonomy in determining other premia payments. The minimum and maximum wage rates for wages charged to costs were frozen for the period 1982-85. As a result, wage growth during this time was largely sustained by promoting workers up the basic wage grids, with little apparent regard to actual qualifications or individual productivity. To some extent the growth in earnings was sustained as well by increasing premia payments.

The authorities sought to broaden the scope of wage reform by various measures taken in 1984. Enterprises considered to be financially sound were given the autonomy to design their own wage tables without being bound by a maximum wage rate, provided that they observed legal requirements in respect of the minimum wage and the payment of certain social benefits. In order to promote increased wage differentiation, the regulations also established a minimum wage spread between the highest and lowest rung within each job category. Limits on the maximum number of job categories and steps within them, however, were retained. So as to reduce the relative importance of premia payments unrelated to productivity developments, new regulations also effectively reduced the size of those premia that were guaranteed by legislation (e.g., seniority benefits). In order to qualify for adoption of the new system of pay, an enterprise had to undertake a job re-evaluation exercise meant to eliminate the effects of wage drift that had characterized the most recent period. The new system of remuneration applied mainly to the material sphere, and by mid-1986 about two-thirds of eligible workers, or over 55 percent of employees of the socialized sector were covered by the new system.

Taxation of an enterprise's wage bill took two basic forms. 1/ In 1982, in addition to the existing flat 20 percent tax on the wage fund, a so-called PFAZ tax on excessive wages charged to costs was introduced for state enterprises in the nonbudgetary sphere. 2/ Increases in a firm's average wage below a certain percentage threshold were exempt from the PFAZ tax. Above this threshold, wage increases would be taxed progressively. The threshold could be raised, however, to the extent that an enterprise was successful in reducing employment. Notwithstanding the latter provision, it has been argued that rather than

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1/ The evolution of this system in the period 1982-86 is discussed in considerably more detail in "Poland - Recent Economic Developments," SM/86/248, Supplement 1 (10/2/86).

2/ PFAZ was the acronym for the State Fund for Occupational Training, to which the tax levies on excessive wages accrued.

motivate enterprises to economize on labor, the basic mechanism encouraged them to hire relatively unskilled workers so as to bring down the growth in the average wage and therefore the likelihood of being subjected to PFAZ levies. (Adam (1984)). In any event, wide-spread exemptions were permitted because of the authorities' concern that this tax, along with the then progressive profits tax (see Section VIII), was discouraging the growth in production (Gomulka and Rostowski (1984)).

The PFAZ tax system was modified in 1983 with a view to improving the relationship between wage increases and productivity gains, as well as inducing enterprises to economize on labor. The basis for calculation was shifted from the average wage of an enterprise to its wage bill. As long as the rate of growth of the wage bill did not exceed a stipulated percent of the growth rate of the firm's net sold production, the enterprise was exempt from the PFAZ tax. The standard coefficient relating the rate of growth of the wage bill to that of net sold production was 0.5, but the Planning Commission could apply higher coefficients in some cases. It also was allowed the discretion to apply to certain enterprises the 1982 system rather than the new one. Some branch ministries were granted the authority to define the output measure for an enterprise as gross output or in physical terms, rather than as net sold production, and some branch ministries allocated lump-sum PFAZ exemptions to subordinate enterprises in return for commitments by the latter to exceed their output targets by fixed amounts (Gomulka and Rostowski (1984)). 1/

With a view to systematizing the growing number of exceptions to the basic rules of the PFAZ, a new wage tax system, the so-called PPWW, was introduced in 1986. Five alternative tax schemes comprised this system, with the Ministry of Labor and Social Policy having the responsibility for their assignment to enterprises.

The first scheme was essentially that applied universally in 1983-85, except that the standard coefficient was set at 0.4, rather than 0.5. A second scheme set a simple ceiling on the tax-free rate of growth in an enterprise's wage bill. Although a standard ceiling was set under this so-called threshold approach, which related to the authorities' planned rate of growth of prices and the assumed change in the overall real wage, some branches, such as coal mining, were authorized to determine the ceiling on a case-by-case basis. The third scheme, applied in labor intensive sectors such as internal trade and other services, was meant to take into account the necessity for output increases in such sectors to be accompanied by roughly parallel rates of growth of employment. In effect, the coefficient relating tax-free wage increases to output was set close to unity. A fourth scheme, applied

1/ Various refinements were made to the PFAZ system in 1984; see "Poland - Recent Economic Developments," SM/86/248, Supplement 1 (10/2/86).

almost negligibly in 1986, was identical to the first scheme except that the tax-free growth in wages was related to profits rather than to net sold production.

An identical schedule of progressive taxation of "excessive" wage increases was applied to each of these schemes, with the tax rates having been increased annually since 1983. In 1986, excessive wage bill increases up to 1 percent greater than the tax-free ceiling were taxed at 100 percent; the maximum tax rate was 500 percent for wage increases more than 5 percent above the tax-free ceiling.

A fifth excess wage tax scheme introduced in 1986 under the PPWW system was the so-called tax on individual earnings. A tax-free individual wage level would be established in successive central annual plans. In effect, to the extent an individual's wage increased by more than the increase in the tax-free wage level, the enterprise would be subject to the PPWW tax, levied progressively up to a maximum rate of 60 percent. It was intended to apply this scheme to sectors characterized by competitive conditions or to enterprises which were deemed to warrant higher than average wage increases. Unlike under the PFAZ system of 1982-1985, exporting enterprises could qualify for so-called "systemic" reliefs for excessive wage taxes under the PPWW mechanism (also see VI.2.).

While previously the quota for tax-free payment of premia and bonuses from after-tax profits had been related to the level of wages charged to costs and to the level of these profits, in 1986 an increase (decrease) in tax-free premia was made dependent on whether after-tax profits rose or fell. Premia payments in excess of the tax-free ceiling were subject to a progressive tax schedule. As with the system for taxing excessive increases in wages charged to costs, certain "systemic" exemptions were also available to qualifying enterprises under the mechanism for taxing excessive premia payments.

Although the PPWW system, with its alternative schemes, was intended to impose order on the plethora of ad hoc reliefs that had characterized the earlier PFAZ mechanism, this new system also quickly became the subject of numerous negotiated exemptions.

In late 1986 the Labor Code was amended to provide for collective bargaining agreements between individual branch ministries and one or more trade unions (of which there were about 100) representing workers within the branches. The branch-wide agreements were intended to establish minimum conditions for wages, benefits, and working conditions in all enterprises belonging to the respective ministries. Draft changes to this code were elaborated in 1988 that were meant to increase the autonomy of both enterprise directors and local trade unions in labor relations. Directors would be given greater flexibility in the hiring and firing of workers, and in their attempts to improve labor discipline. Local trade union officials would, at the same time, be given more latitude for challenging the decisions of enterprise management.

Draft legislation was introduced by the Government in 1988 designed to tie remuneration more closely to worker productivity. One provision of the draft law would give enterprises the legal right to abolish various elements of wages which heretofore had been mandatory, such as the seniority bonus. Other elements of compensation, however, such as overtime pay and bonuses allowable for the calculation of the base wage for pensions, would still be subject to rules established outside the enterprise.

The PPWW system of taxation of excessive wage increases was left essentially unchanged in 1987. Despite this tax however, excessive wage growth continued in 1987 and an additional levy was in principle imposed on any increase above 12 percent in an enterprise's wage bill. There were numerous planned "systemic" exemptions to this surcharge, and together with proliferating ad hoc reliefs, it proved ineffective in preventing wages from growing by 21 percent compared with a target of 13 percent.

The price-incomes operation of 1988 was accompanied by a substantial revision of the PPWW system. All socialized enterprises were classified into one of two categories. Enterprises accounting for over 60 percent of employment were subject to a system of "taxation of individual wages," according to which an amount of an individual's wage equal to 60 percent of his 1987 wage, subject to various adjustments, was free of any excess wage tax. A wage above this level was subject to a progressive rate of taxation. This system in effect was a variant of the fifth scheme under the 1986-87 PPWW mechanism.

The second system was similar to the second ("threshold") scheme under the previous PPWW mechanism. It applied to just under 40 percent of employment in socialized enterprises, mainly in public utilities and other enterprises for which the possibilities for increasing profits were limited. Subject to various adjustments, these enterprises could increase their wage fund by 30 percent without having to pay any PPWW tax, which was also progressive in nature. As before, the PPWW tax was chargeable against profits (after income tax) available for distribution.

Both of these systems allowed for many potential adjustments and possibilities for partial exemptions, and were viewed by enterprise management and the bureaucracy administering them as exceedingly complex. Equally complicated was the procedure for determining the tax-free quota for premia distribution from after-tax profits. In the first few months of 1988 wage growth significantly outpaced the planned rate, and in response to the labor unrest of April-May 1988 this rapid rise in wages was in part validated and partially reinforced by an increase in the tax-free ceiling by 7 percentage points for both wage schemes.

Under the extraordinary powers, a decree was issued in May 1988 that eliminated any further ad hoc PPWW reliefs. Moreover, enterprises would lose whatever "systemic" reliefs they might be entitled to and their PPWW liability would be doubled if their pre-relief PPWW tax liability exceeded 25 percent of their planned profit after income tax. The payment schedule for the PPWW tax was also accelerated. Despite these attempts to rein in exceptions under the PPWW system, various reliefs were allowed in the second half of the year particularly to encourage increased output of products (and their inputs) which, in an environment of growing shortages, the authorities were determined should be in "continuous supply." The basic threshold before imposing the PPWW tax was also increased again, in the third quarter; moreover, tax relief was provided to enterprises in branches where an "improvement in wage proportions" was deemed necessary, and the second wave of strikes in August prompted further PPWW exemptions. For the year as a whole PPWW reliefs amounted to Zl 310 billion, compared to revenues from this tax of Zl 210 billion. 1/

The wage regulation system to be applied in 1989 was fundamentally different from those mechanisms previously experimented with in Poland. Under the new system, socialized economic units in the material sphere were to be allowed in 1989 to charge to their "justified" (i.e., tax deductible for income tax purposes) costs wages equal to 140 percent of the level of wages (charged to costs) in 1988. Any increase in wages of greater than 40 percent--a figure which was broadly pegged to the planned year-on-year increase in retail prices "exclusive of the effects of alcohol and tobacco"--would be considered unjustified costs and would not only not be tax-deductible, but would be added to taxable income and taxed at the statutory 40 percent rate. If the wage bill also were to increase more rapidly than the firm's value added, the enterprise would be liable for a penalty tax equal to 200 percent of the amount of the excessive wage payment. 2/ Enterprises producing basic consumer services or supplying agriculture, firms using a multiple shift system, and enterprises producing goods for use in construction of housing or related infrastructure would be eligible for reliefs. A maximum relief rate of up to 50 percent of the value of excess wage payments would be allowed.

Tax free premia paid from after-tax profits were to be calculated in 1989 on the basis of a simpler formula than previously, and certain enterprises which faced administered prices for their products and/or

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1/ Revenues and reliefs from this tax in 1986 and 1987 were broadly equivalent in magnitude.

2/ In no event, however, would an enterprise have to pay an effective income tax rate greater than 50 percent. If the penalty taxes mentioned in the text were to imply a effective rate higher than 50 percent, then only 50 percent of the enterprises "excessive" wages in 1989 could be included in the base wage bill for 1989 to be used in calculating excessive wage payments in 1990.

price subsidies would be guaranteed a minimum tax-free quota for premia payments. Because the ceiling on wages charged to costs would be effectively fixed under this approach, increased after-tax profits would become the route to incremental increases in employee remuneration, although only in the following year. 1/

The series of PFAZ (1982-85) and then PPWW (1986-88) wage regulation schemes devised by the authorities over this period were most notable for their complexity and their lack of success in keeping wage growth within the limits set out in successive annual plans. In the period 1985-87, for example, the annual target for the growth of average monthly earnings in the socialized sector was 13 percent; the actual growth in earnings regularly exceeded this level, by 6-8 percentage points. In 1988, when the average wage was planned to grow by 42 percent, it actually increased by 82 percent. Clearly, the successive systems of wage regulation have been ineffective, but they have not been implemented consistently enough to conclude that they were necessarily faulty in design. Rather, from the beginning numerous exemptions to the various excessive wage taxes were negotiated, on both a "systemic" and ad hoc basis, a symptom in turn of the very lack of financial discipline which the tax schemes were designed in the first place to offset.

At the same time, and despite greater enterprise autonomy with respect the the setting of individual pay scales, little progress appears to have been made towards greater wage differentiation reflecting productivity differentials. 2/ The problem of relating income to individual performance within the material sphere has also been compounded, in the economy as a whole, by the growing influence of formal or informal parity arrangements. This is reflected, for example, in the increasingly key role played by the negotiated rural-urban parity ratio in determining the incomes of the agricultural population, and the Government's decision to establish a new basis, effective in 1989, for indexing wage growth in the budgetary sphere to that in the material sphere. 3/ An agreement formally to index wages in the latter sphere to retail prices was a prominent outcome of the roundtable discussions in April 1989. Aside from reflecting the acceleration of open inflation,

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1/ Premia paid from after-tax profits were to be tax-free as long as their share in after-tax profits was not greater than the share of wages charged to costs in total costs in 1988. Premia payments in any event could not exceed 50 percent of after-tax profits. The rate of tax on premia payments that exceeded the tax-free ceiling was 200 percent.

2/ Niewczas and Stawicki (1987) indicate that most measures of wage differentiation showed at best only small increases between 1981 and 1985, and that in many cases the degree of wage differentiation was lower in 1985 than in 1978.

3/ In Poland it is common to refer to this phenomenon as "the struggle over the distribution of incomes" (Pajestka, et al (1986) and Zienkowski (1987)).

the proliferation of parity arrangements undoubtedly has in turn reinforced underlying inflationary pressures in the economy. In this way a vicious circle arises which is accommodated by the fiscal and credit policies of the authorities.

2. Labor market policies

Several factors, including various policy measures taken in 1980-81, a slowing in the rate of growth of the population of working age, and a rapid increase in employment in nonagricultural private activities, resulted in a sharp decline in employment in the socialized sector between 1981 and 1983. With unemployment remaining negligible and activity in this sector reviving in later 1982 and 1983, enterprises increasingly complained of labor shortages. To some extent these shortages were caused by regional imbalances that in turn were aggravated by chronic housing shortages, as well as by inadequate incentives for labor saving. Labor mobility continued to be mainly determined by the decisions of employees rather than of enterprises, which were reluctant to dismiss labor. Reflecting the tight labor market conditions, wage increases consistently exceeded plan targets, although nonwage benefits--such as the provision of housing--also continued to be an important factor in attracting or holding on to workers.

In the course of 1982-86, the authorities undertook various measures designed to alleviate these labor shortages. In 1983, a system for centrally allocating labor was introduced in the most industrialized regions to ensure that priority tasks were completed as scheduled. This system was dismantled in 1985, when the existing network of labor exchanges resumed its previous role as labor market intermediary. Other measures included attractive wage schemes to encourage retired workers to re-enter the workforce; higher pensions for workers who chose to postpone retirement; extended working hours in priority sectors and the formation of teams of workers to work in these sectors after hours at bilaterally negotiated wage rates; and tax benefits for enterprises achieving increases in labor productivity.

Various measures aimed at alleviating labor shortages in the material sphere of the socialized sector were continued in 1987-88. These included governmental housing guarantees and preferential housing credits designed to encourage geographical labor mobility, and draft changes in the labor code which would expedite the mobility of managers who were successful candidates in competitions for positions in different enterprises. In an attempt to improve the efficiency with which labor was used, the authorities were continuing to encourage the creation of work teams that operate during regular working hours (rather than after hours) for a base wage plus a bonus that is directly related to their performance, including the quality of their products which is considered to be solely their responsibility. These teams were estimated to account for some 12 percent of employment in socialized industry in 1988. Despite these and other measures to raise the efficiency of use of the existing work force and to facilitate its mobility, the gap between job vacancies registered by enterprises with the labor exchanges and the number of registered job seekers continues to be wide.

VIII. Fiscal Reform

A fundamental principle of the 1981-82 reform blueprint, as noted earlier, was the expanded use of so-called economic instruments to guide enterprises in fulfilling the priorities of the central planners as well as making efficient use of the resources at their disposal. This involved, inter alia, "putting the sphere of taxation into order" (Plenipotentiary (1982)) and modifying the system of taxes and subsidies so as to impose greater financial discipline on enterprises.

Under the reform there were essentially three types of taxes levied on enterprises: (i) a turnover tax; (ii) taxes on various inputs (a flat tax on the enterprise wage bill, a real estate tax, and a charge on the depreciation write-offs of enterprises subordinate to founding bodies that were units of the central government); and (iii) direct taxes.

Turnover taxes remained highly differentiated, ranging in 198[illegible] from 5 percent to 85 percent of sales value with a weighted average rate of about 30 percent. The Minister of Finance had the authority to change turnover tax rates within a budget year.

Prior to 1982 there had been no important direct taxes levied on state enterprises. In 1982, both an income (or profits) tax and a tax on excess wages (see Section VII), along with a temporary stabilization tax, were introduced. The profits tax was at first progressive but with concerns that it would tend to discourage increases in production it was replaced, in 1984, with a linear tax of 60 percent (raised to 65 percent in 1985). Reliefs from this tax tended to grow in importance over time; whereas they accounted for 5 percent of profits tax revenues in 1982, reliefs had grown to 20 percent of collections by 1986. 1/

The system of taxation of profits of nonsocialized firms and of household incomes remained fairly complex. With the exception of individuals earning exceptionally high incomes from socialized sector activities or performing supplementary work in this sector under contracts, and incomes of employees in the nonsocialized sector, the population's regular earnings were not subject to an income tax.

The reform blueprint had envisioned a more active role for the budget as an instrument of macroeconomic stabilization, but a smaller

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1/ Such ratios may overstate somewhat the importance of tax reliefs, but by the same token understate the importance of subsidies, to the extent that objective (or price) subsidies paid to enterprises are sometimes subtracted from their income tax obligations.

role in the discretionary intermediation of resources within the economy at the microeconomic level. Between 1982 and 1983, the share of state budget expenditure in GDP declined from 53 percent to 41 percent, where it remained through 1986. This pattern largely reflected the success, in the early period of the reform, in reducing budgetary subsidies (by 14 percent of GDP between 1981 and 1983), and the broad stabilization of the subsidy share in national income thereafter. At the same time, state budget revenues as a percent of GDP broadly stabilized in 1983-86 at a level only marginally lower than in 1981. These aggregate trends were broadly mirrored in the decline in the deficit on general government, as a percent of GDP, from 10 percent in 1981 to an average of 0.5 percent in the period 1983-86.

While these trends were evidence of diminished overall intermediation by the budget on the expenditure side in the early phase of the reform, there was little sign that the extent of effective intermediation had been reduced at the microeconomic level. Although so-called subjective, or noncommodity specific subsidies, fell quite rapidly in real terms beginning in 1982, there was, as noted, considerable and apparently growing use of reliefs from the enterprise income tax and excessive wage tax and therefore substantial differentiation of effective tax rates among sectors and, within sectors, among enterprises in this period. The pattern of exemptions reflected both the development priorities of the authorities, in which case the nature of the relief was published beforehand (so-called "systemic" reliefs), and variable pressures for exemptions from unprofitable branches or enterprises.

In the course of 1987-88, little progress was made in making the system of fiscal instruments more uniform and less discretionary in application. On the revenue side, some 400 different turnover tax rates remained in force, with rates ranging from 0 to 90 percent of the sales prices of different products. The system of taxes on inputs remained basically unchanged, although beginning in 1988 the portion of enterprise depreciation allowances being turned over to the Government began to accrue to a newly established Industrial Restructuring Fund, an extrabudgetary fund designed to provide credit to enterprises undertaking approved projects aimed at structural change and modernization.

Reliefs from the tax on enterprise profits continued to grow in 1987, when they were equal to about one-third of total profit tax revenues. They also continued to grow in nominal terms in 1988, but their importance declined--to about 25 percent of profit tax revenues--and the effective income tax rate for enterprises rebounded to slightly over 50 percent (against a statutory rate of 65 percent). 1/

1/ Burgeoning reliefs from the PPWW tax in 1988 have already been discussed (see Section VII).

Revenues and expenditures of general government both broadly stabilized at between 48 percent and 51 percent of GDP in the period 1983-88. This suggests essentially no change in the intermediation role for the budget in recent years, a picture that is at least reinforced by the continued highly differentiated and frequently discretionary application of tax rates, noted above, reflecting a continuing intense bargaining process between enterprises and the budget over taxes and other charges. On the expenditure side, so-called subjective subsidies to enterprises continued to fall in real terms in 1988, but price subsidies, despite the intentions of the authorities as expressed in their price-incomes operation early in the year, continued to grow in real terms. Food subsidies to the population increased by more than 50 percent in real terms in 1988, and alone they accounted for 14 percent of total state budgetary expenditure, almost equal to their peak share in 1981, before the price reform of 1982. Total state budget subsidies continued to equal about 15 percent of GDP in 1988 (1983: 16 percent).

A substantial program of fiscal reform is planned by the authorities for the period 1989-1991. The number of individual turnover tax rates has been reduced to less than 100 positions in 1989 as a step toward introducing a value-added tax (VAT) in 1991. The profits tax rate for state enterprises has been lowered to 40 percent in 1989 and this rate will apply uniformly to all economic units, whether state enterprises, cooperatives or private firms. 1/ Systemic reliefs from the income tax will be available for exports (Section VI), production of high quality products, defense production, energy conservation, and for enterprises producing under government contracts. Taxes on net fixed assets and revaluation of enterprise stocks, previously levied to finance the zloty obligations of the Foreign Debt Servicing Fund (FOZZ) to Bank Handlowy, were to be replaced by an increase in the basic turnover tax rate, with the higher taxes in this regard to be collected directly by the central budget. 2/ A universal personal income tax, which would significantly simplify the taxation of the earnings of the population--except those deriving income from agricultural production--is to be introduced in 1991.

As regards price subsidies, the authorities intend to move toward a system in which the specific (not ad valorem) per unit subsidy will in principle be made uniform for a given product group, across producers, independently of their particular financial position. Producers will receive augmentations to this uniform subsidy, however, to reflect various "objective" factors such as higher transportation costs for

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1/ Recall that state enterprises will also pay a dividend to the state treasury determined, in principle, by the application of the basic, or refinancing, rate of the NBP to the state's investment in the firm represented by the so-called founding body's fund (Section IV.2.b.).

2/ The central budget will in turn pay a subsidy to the FOZZ.

inputs in some regions. The general aim of this change is to encourage enterprise efficiency. The authorities have proposed that in 1989, rather than let the level of price subsidies be determined by price policy, the principle be adopted that the target level of price subsidies will in part determine pricing. This would mean that each change in procurement and other input prices would be reflected in retail prices and not in the size of subsidies. Effective January 1, 1989, the coal community began to receive a price subsidy on domestic sales equal to the difference between the (quality adjusted) transaction price received on exports of coal exports to the nonruble area and the domestic administered price for coal.

In sum, the authorities are currently embarked on reforms of the systems of both enterprise and individual taxation, intended to provide fiscal underpinning to the need for greater financial discipline and equality of treatment of different ownership forms, and to establish greater uniformity of taxation for individuals. These reforms will take several years, and in the meantime, fiscal policy in respect to enterprises is still characterized by a highly differentiated and discretionary approach which, as the "command-distribution" system with its emphasis on assigned quantitative tasks has gradually been dismantled, has become the major medium by which enterprises bargain with the authorities over the carrying out of priorities of the latter and the avoidance of strict financial discipline.

IX. Banking and Financial Market Reform

1. 1981-86

The reform program accepted at the 1981 PUWP Party Congress called for elimination of shortages and administrative allocation of resources in part as a means to ensure the domestic convertibility of the zloty into goods and services (Balcerowicz (1988)). But while stress was laid on the need to restore and maintain balance in the market for goods and services, little attention was directed to the problem of encouraging (rather than forcing) saving and efficiently allocating this saving to the most effective investments. This area was one of the most neglected in the reform program and in the subsequent reform initiatives undertaken in the course of 1982-86.

As noted in Section IV, virtually no initiatives were undertaken in the period 1982-86 regarding new ownership forms or the creation of new financing instruments for enterprises in the socialized sector. While now formally autonomous, state enterprises were restricted to the three traditional sources of investment funds: retained earnings and depreciation charges, budgetary and extrabudgetary subsidies, and bank credits. Under the reform program, enterprises were to become less dependent on investment subsidies. Nevertheless, this source of investment still financed 15 percent to 18 percent of enterprise investment in the period 1982-87, with no evident downward trend in this share. 1/ An even broader range of investment continued to be influenced by formal and informal pressures from the center and the branch ministries, as well as by the rationing of material inputs and even some final investment goods.

Under legislation enacted in February 1982 the state banks, and in particular the National Bank of Poland (NBP), were to be "autonomous organizational units." The NBP ceased to be formally subordinate to the Ministry of Finance and was given responsibility for formulating the annual credit plan which, although coordinated with the central annual plan, was no longer viewed as automatically accommodating the requirements of the latter. The legislation provided for a Banking Council, however, which included inter alia representatives of the Planning Commission and the Ministry of Finance. The council presented opinions both in respect to the credit and other financial plans drawn up by the different banks and their implementation of these plans. In separate legislation, the NBP also was to "cooperate with appropriate bodies of the state authorities and administration in determining and implementing the economic policy of the state and particularly in shaping the monetary-credit policy which is defined by the Sejm and the Council of Ministers" (Polish Chamber (1982)).

The new banking legislation called for the NBP (and therefore its operational branches) and other state banks to extend credit on the basis of sound criteria that were compatible with the principle of enterprise self-financing (Sadowski (1982)). A set of criteria were later elaborated, 2/ but these guidelines were waived in the case of centrally planned investments (consistently 16 percent of total socialized sector investment in the 1982-86 period), and cooperative residential construction (a similar share of investment). Working capital credits also continued to be granted with little regard to the profitability of the borrowing enterprise. Preferential access to and interest rates on credits were available to a number of priority sectors. In 1982 and subsequent years even standard credits were extended at only marginally higher nominal interest rates than before the reform. Enterprises were therefore able to borrow at interest rates that were also significantly negative in real terms throughout this period. In these circumstances, and in view of continuing distortions in the structure of prices and therefore in the pattern of profitability, direct credit controls remained the principal instrument of monetary management.

Although enterprises were permitted to open time deposits with the banking system in 1982 and interest rates were raised marginally on their other deposits, all these rates were significantly negative in

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1/ Comparable data are unavailable for the period prior to 1982.
2/ See "Poland - Recent Economic Developments," SM/86/248 (10/1/86) for details.

real terms in the 1982-87 period and could not have provided much inducement to enterprises to increase their holdings of available financial assets. More profitable, for most of this period, was the investment of idle funds either in new investment projects or stock-building. There was no opportunity for enterprises with excess funds to invest directly in other enterprises with an excess demand for funds; 1/ neither did they have much of an incentive to leave such funds with the banking system for intermediation.

Interest rates were also raised in 1982 on household deposits and credits to private firms and the population. These also remained negative in real terms throughout the period 1982-87, however, even in terms of the official rate of inflation. At times, this rate may have been lower than the growth rate of prices in the second economy, which could be considered a better measure, in a situation of excess demand for output of the socialized sector (at prevailing, largely controlled prices) of the opportunity cost to households of holding broad money.

Given the inability to issue obligations and the apparent unresponsiveness of bank interest rates to fluctuations in supply and demand, state enterprises effectively had no way to bid either directly, or indirectly through the banking system, for household savings in this period. At the same time households, although quite possibly eliminating their "excess" liquidity through second economy purchases at uncontrolled prices, in effect were left with money holdings that were determined very little by interest rates but rather by their money incomes and the nominal supply of consumer goods and services available from the socialized sector. 2/

2. The second stage of reform

The implementation program for the second stage of the reform laid great stress on achieving equilibrium in the economy by strengthening the currency, as well as through price restructuring. Included as measures to strengthen the zloty were the "conduct of an appropriate credit policy for working capital and investment credits, taking into account the rate of inflation, as well as (the setting) of interest rates on time deposits that would ensure their real value." (Council of Ministers (1987)). 3/ The program also provided for a two-tier banking

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1/ An unknown magnitude of inter-enterprise credit, however, was extended both voluntarily, under cooperative agreements, and involuntarily.

2/ Given a fixed level of socialized sector output and fixed prices for this output, the magnitude of second economy transactions would have no effect on the nominal (zloty) money holdings of the socialized sector as long as consumer purchases were not diverted from that sector to the second economy.

3/ The importance of a tight monetary policy in the support of sustainable reform in Poland is stressed by Baka (1988).

system in which new commerical banks would operate on the principles of self-financing and competition, and enterprises would be free to choose their bank.

With the introduction of the price-incomes operation in early 1988, nominal interest rates were raised significantly and banking authorities spoke for the first time of establishing rates that were "realistic." In the event, price increases overshot the plan by a considerable margin (the all-inclusive within-year increase in retail prices was 74 percent), and interest rates on deposits turned out to be more negative in real terms in 1988 than in any of the preceding years under the reform. Interest rates on enterprise deposits were even more negative in real terms, and interest rates on credits, which were now permitted to range as high as 30 percent on loans in arrears, were also substantially negative when viewed against the backdrop of high inflation.

With the perpetuation, and indeed deepening of negative real rates of interest on both the assets and liabilities of the banking system, fundamental integration of the money market in Poland cannot be said to have advanced in 1987-88. The structure of interest rates planned by the authorities for 1989, however, would in the light of their plans for price increases appear to have reflected broadly a genuine commitment to positive real interest rates on deposits and an interest rate structure on credits designed to ensure the profitability of the newly established commercial banks (see below).

The first major step in decentralizing the banking system was taken in November 1987 when the PKO Savings Bank was reestablished as a savings bank independent from the NBP. At the beginning of 1989, nine new commercial banks were established to carry out the credit and other commercial operations previously conducted solely by branch offices of the NBP. The new banks were initially to be predominant in different regions, with each bank covering about five of the 49 voivodships (or provinces). Besides inheriting most of the NBP's operational branches--and corresponding assets and liabilities--in its own region, each commercial bank was to receive some branches in other regions. The new banks would be free to set up new branches without restraint and to offer, subject to the acquisition of the necessary expertise, any banking services including foreign currency operations. These services could be offered to both enterprises and households. Although socialized enterprises would be permitted to deal with a multiple number of banks, they would be required to maintain a so-called basic account with one particular bank which, however, they would be free to choose. The banks would be permitted to set their own deposit and lending rates within prescribed ranges and also to set charges within specified limits. (IMF, Central Banking Department, (1988)). Although the commercial banks were in principle to be fully autonomous in such matters, the authorities have indicated that such independence will only be phased in over several years. Other existing state-owned banks, including the PKO Savings Bank, the Bank for Food Economy, Bank Handlowy, Bank PKO, S.A. and the Export Development Bank, are in principle to be free to compete with the new commercial banks in the provision of all banking services. The monetary authorities are presently in the process of formulating a set of new instruments for credit and monetary control as well as procedures for supervising the more decentralized banking system. 1/

Steps to develop a capital market have until now been of negligible importance in Poland. Under regulations effective January 1, 1986 (Zdyb (1988)), only three state enterprises had issued bonds through September 1988. In that month, however, a new law was passed that was designed to liberalize conditions for the issuance and purchase of bonds. Under the new legislation any legal entity, regardless of form of membership and including social organizations, foundations and local authorities, was to have the right to issue bonds. For the first time, households would also be able to buy these securities. 2/ The issuers of bonds are to be relieved of the obligation first to obtain the approval of the authorities. They would be obligated, however, to issue the securities through public subscription accompanied by the publication of a prospectus containing, inter alia, information on the interest rate as well as the so-called "companion benefits" payable to bond holders. The latter benefits may include a priority claim on production of the issuer.

Recent years have seen the growing acceptance of the principle that borrowings by the budget from the banking system should not be at zero rate of interest, although this principle has yet to be implemented. The 1989 budget law provided for a limited issuance of government obligations, probably to be purchased by the banking system, which was viewed as a step toward the establishment of a market for interest-bearing government securities as a source of budgetary financing.

Viewing the period 1981-89 as a whole, it is evident that the basic system for intermediation between savings and investment underwent little fundamental change during the "first stage" of reform. Throughout this period, and despite legislation intended to make the NBP more autonomous and the provision of credits by its branches subject to

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1/ A major issue in monetary control is how to take into account the change in value of the population's holdings of foreign currency due to inward transfers as well as changes in the exchange rate at which these holdings are evaluated by the population. At the end of 1988 foreign currency deposits accounted for about one-quarter of the population's holdings of broad money if valued at the official exchange rate. This proportion would be much higher if the (unknown) value of foreign currency in circulation were taken into account and if holdings of foreign currency were valued at the parallel market rate.

2/ Under the previous legislation only state enterprises were entitled to issue bonds and only socialized units were entitled to their purchase.

"business-like" criteria, there was more or less passive accommodation of enterprise credit demands and interest rates on bank deposits and credits continued to be negative in real terms.

The implementation program of the second stage of reform included a renewed commitment to establishing the autonomy of the NBP, a plan for setting up a two-tier banking system with independent credit banks operating on profit-making criteria, and a policy of positive real rates of interest. New legislation enacted in 1988-89 and policy principles enunciated in this period have complied with the objectives of the second stage, but in practice credit policy has been more accommodative than planned and a significantly higher basic structure of nominal interest rates has been subject to a wide range of preferential credit rates and swamped by rising above-plan rates of inflation. Some initiatives have been taken to encourage the issuance of securities by enterprises and other organizations to the public at large, but these developments are still at only a very early stage.

X. Agriculture

As noted in Section II, collectivization of agriculture was slow to take shape in Poland and following the sociopolitical crisis of 1956 a policy of decollectivization was announced. Private ownership continued to play a predominant role in agriculture, although between 1970 and 1980, partly as a result of a decision by the PUWP gradually to socialize agricultural land and a number of administrative measures, the share of privately owned land fell from 81 to 75 percent. The authorities were intent upon maintaining the performance of existing private agriculture, however, and in the early 1970s mandatory private deliveries to the state were abolished. The 1970s were thus a period of conflicting tendencies with respect to institutional arrangements in agriculture.

The social upheaval of 1980-81 was accompanied by greater demands by private farmers for independent farmers' organizations, more equal access of nonsocialized agriculture to credits and inputs, and a guarantee of private family-run farms as a permanent fixture of the Polish economy. The latter two principles were broadly accepted by the government in the course of 1981-83, and the legal and basic economic position of nonsocialized agriculture was enhanced in comparison with the 1970s. 1/

Private agriculture, however, remained heavily dependent on the socialized sector and on governmental policies toward it. Virtually all agricultural inputs were subject to administrative prices, usually with large subsidies, and were distributed by state agencies (Section IV) in relation to the scale of deliveries of agricultural products by

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1/ In 1985, a land tax reform was introduced which equalized the tax burden for all agricultural sectors.

individual farmers to state procurement agencies. Throughout the 1980s roughly 85 percent of marketed output has been sold to these agencies, about 70 percent at administered prices. These prices and those for agricultural inputs sold by state agencies have typically been set annually by the government with the aim of influencing the agricultural product mix as well as attaining a socially agreed value for the parity ratio between rural and urban incomes. Some observers have viewed this set of relations between private agriculture and the socialized sector as a real world application of the model of a "regulated socialist market economy." 1/

The implementation program of the second stage of reform called for equilibrium in the agricultural and food markets within two to three years. Major initiatives were to include the reform of the basis for setting the prices of agricultural inputs and produce, and abolition of centralized direction of trade in inputs and agricultural products, including the elimination of the monopoly over procurement of food and in food processing. Reforms were also proposed that would facilitate the private exchange of farmland.

The major reform initiative actually undertaken in the agricultural sphere in this period involved the legal elimination, effective January 1, 1989, of the state monopoly in the procurement of most basic agricultural and food products. The development of effective competition in the food processing industry, however, is expected to take several years. By agreement at the social roundtable in April 1989, agricultural input prices were to be freed, along with those of retail supplies of most food products. These actions, together with the previously mentioned abolition of ceilings on agricultural procurement prices, were to be taken as part of a program to "marketize" agriculture in the second half of 1989.

1/ Some would see the model as appropriate for the industrial sector as well. Others emphasize the inefficiency of the present institutional arrangements governing agriculture. See Fallenbuchl (1988).

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