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December 24, 1992

To: Members of the Executive Board

From: The Acting Secretary

Subject: Poland - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a paper on Poland's request for a stand-by arrangement in an amount equivalent to SDR 476 million, which is proposed to be brought to the agenda for discussion on Wednesday, January 13, 1993. Draft decisions appear on page 19.

Mr. Ebrill (ext. 37893) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Request for Stand-By Arrangement

Prepared by the European I Department and the Policy Development and Review Department

(In consultation with other departments)

Approved by Massimo Russo and Jack Boorman

December 22, 1992

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I. Introduction

Negotiations on a program to be supported by a stand-by arrangement were held in Warsaw from November 3-24, 1992. 1/ The staff met with Mr. Goryszewski, the Deputy Prime Minister; Mr. Osiatynski, the Minister of Finance; Mr. Kuron, the Minister of Labor and Social Security; Mr. Kropiwnicki, the Minister of the Central Planning Office; Mr. Lewandowski, the Minister of Privatization; Mr. Barbuski and Mr. Kozinski, the Vice-Presidents of the National Bank of Poland (NBP); and senior officials of government ministries and the National Bank of Poland.

In a letter and accompanying memorandum on economic policies dated December 14, 1992 (EBS/92/219, 12/22/92), the Minister of Finance and the President of the National Bank of Poland request the cancellation of the existing extended arrangement with the Fund and the approval of a 14-month stand-by arrangement in the amount of SDR 476 million (48 percent of the quota under the Ninth General Review).

In concluding the 1992 Article IV consultation with Poland (EBM/92/99, 7/31/92), Executive Directors commended the authorities for the progress that they had made in transforming the economy over the part two years despite an adverse external environment. They emphasized, however, that an acceleration of reforms was essential to speed up the restructuring of the economy, support a sustained recovery of output, and underpin stabilization. The interaction and mutually reinforcing effects of macroeconomic stabilization policies and structural reforms were noted. The need for decisive early action in these areas was reinforced by the fragile medium-term outlook.

As regards recent political developments, the passage of the so-called "small constitution" strengthens the executive branch and also clarifies the respective powers and responsibilities of the Government and the President. In particular, before voting to remove a sitting government, Parliament is now required to propose an alternative supported by an absolute majority; Parliament is also now able by a majority vote to vest the Government with the right to issue decrees with the force of law. Certain legislative areas--for example, the budget, social security, and labor benefits--are excluded from this procedure.

II. Background

As reported at the time of the Article IV consultation (SM/92/139, 7/9/92), developments in Poland were generally favorable during the first half of 1992. Industrial production rebounded strongly--by 22 percent between December 1991 and July 1992 on a seasonally adjusted basis; the

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1/ The staff team consisted of Messrs. Deppler (EU1), Allen (Senior Resident Representative), Ebrill, Banerjee, Chopra (all EU1), Enders (PDR), Schwartz (FAD), and Mrs. Ricasa (EU1) as Administrative Assistant.

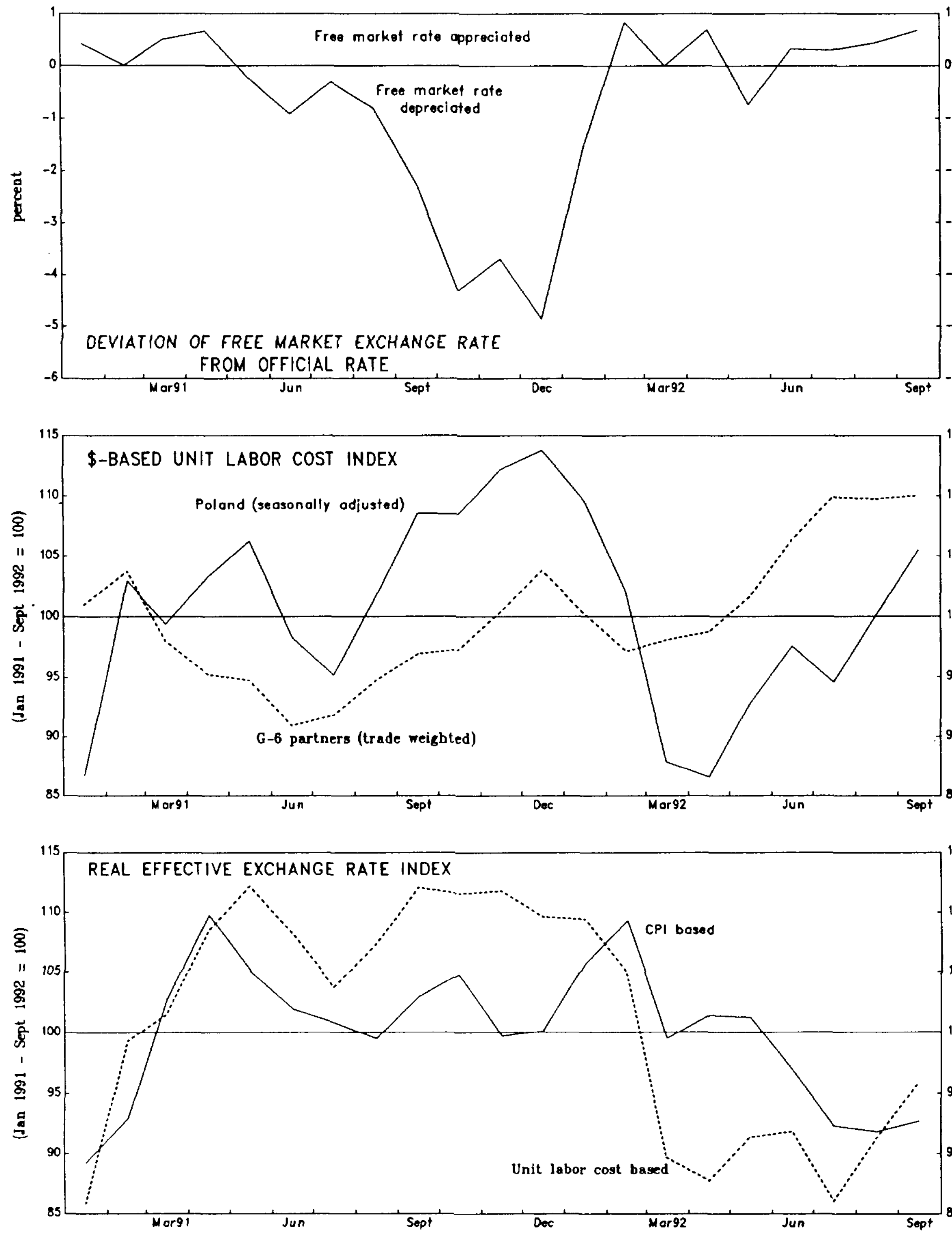
12-month rate of inflation slowed to 41 percent at midyear from 60 percent six months earlier; the trade balance was strengthened by strong export growth; international reserves increased by US$2 billion between January and August; and the fiscal deficit was contained to annual rates below 5 percent of GDP.

The strength of activity in this period does not appear to be attributable in the first instance to domestic demand factors: investment spending was weak, public expenditure and real wages declined in real terms, and the fiscal deficit in the first half of the year was smaller than in the previous half year. Rather, developments in the first half of the year are more consistent with favorable domestic supply effects, assisted in part by increased access to EC markets, a 14.4 percent devaluation, and continuing gains in competitiveness (Chart 1). Two parallel developments that lend credibility to this interpretation are, first, the increasing importance of the flourishing and relatively untaxed private sector, which in September 1992 accounted for some 58 percent of total employment and 27 percent of employment in industry, the traditional preserve of state enterprises; and, second, reports of medium-sized state enterprises that are finding niches within their traditional product lines on which they can prosper as a scaled down business.

Developments became more mixed in the second half of the year. On the one hand, industrial activity and exports remained on a rising, if more subdued, trend (Chart 2); recorded unemployment, which had been rising at a decelerating rate, actually declined slightly in October; business expectations about output and exports, which had been improving steadily, improved markedly further in October (Chart 3); and investment spending intentions, which had been quite weak, began to firm. On the other hand, a number of indicators became less favorable: 12-month inflation accelerated to some 47 percent in the closing months of the year because of a steep, drought-induced rise in food prices (nonfood price inflation stabilized at around 36 percent); capacity constraints grew in importance for some companies; the trade balance weakened, partly because of reduced agricultural exports, but also because of buoyant imports; and reserves declined somewhat during the closing months of 1992, albeit partly for seasonal reasons.

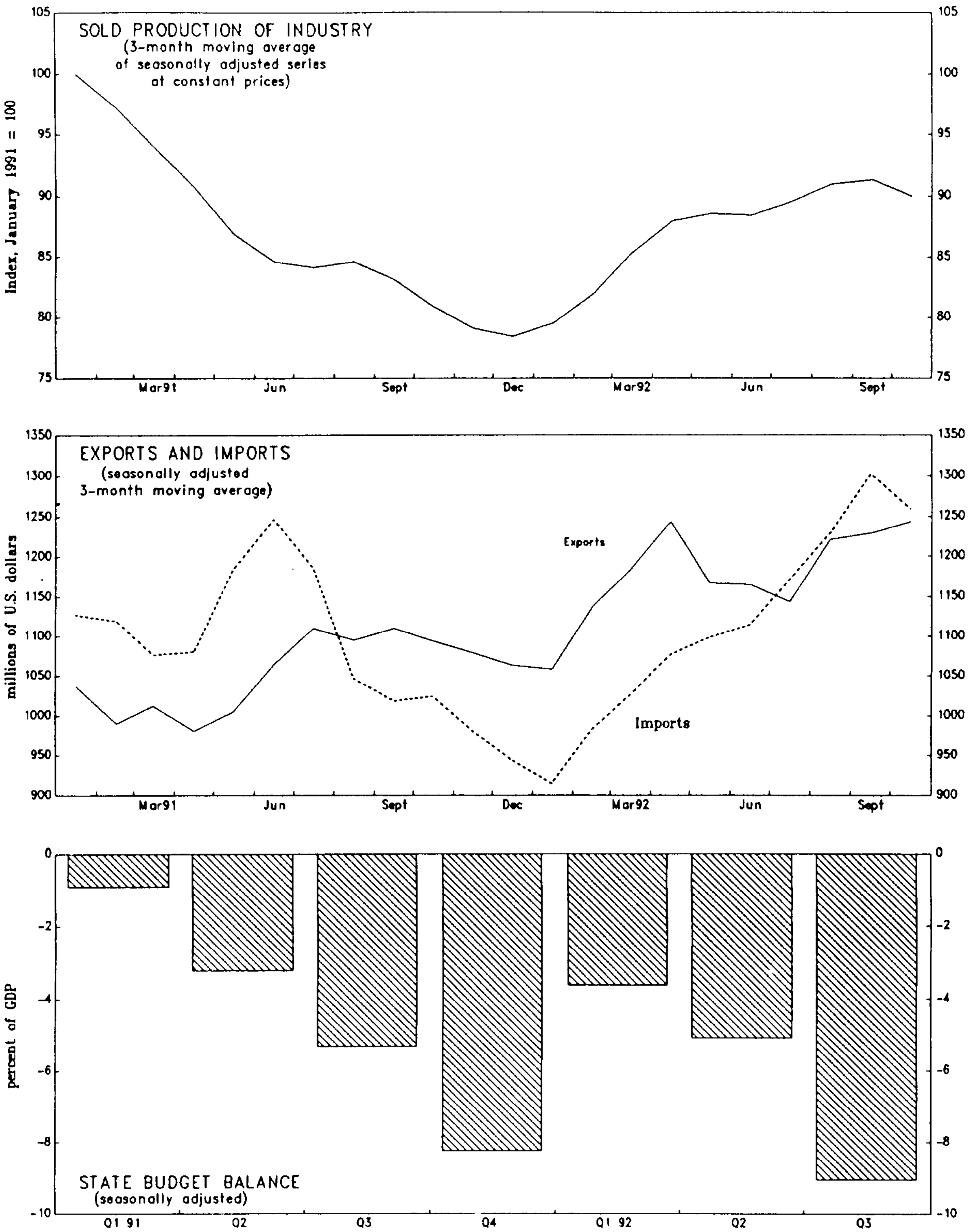
The emerging strains suggested by the latter developments took on a more threatening cast in the face of a large and rapid deterioration in the fiscal deficit. The state budget deficit widened significantly in the third quarter (Chart 2). It will increase further in the fourth quarter, well into double digits as a percent of GDP, when about one half of the deficit for the whole year is to be incurred, despite counteracting measures taken by the authorities in that quarter. Overall, the state budget cash deficit, which was originally intended to be around 5.7 percent of GDP, is likely to have widened to about 8.6 percent of GDP for the year as a whole. The main factor behind the deterioration was a 10 percent shortfall in revenues relative to the original budget, which translates to a shortfall of 3 percentage points of GDP. This shortfall, notwithstanding the buoyancy of economic activity, was mainly on account of delayed implementation of

Chart 1
POLAND
EXCHANGE RATE INDICATORS, 1991-92



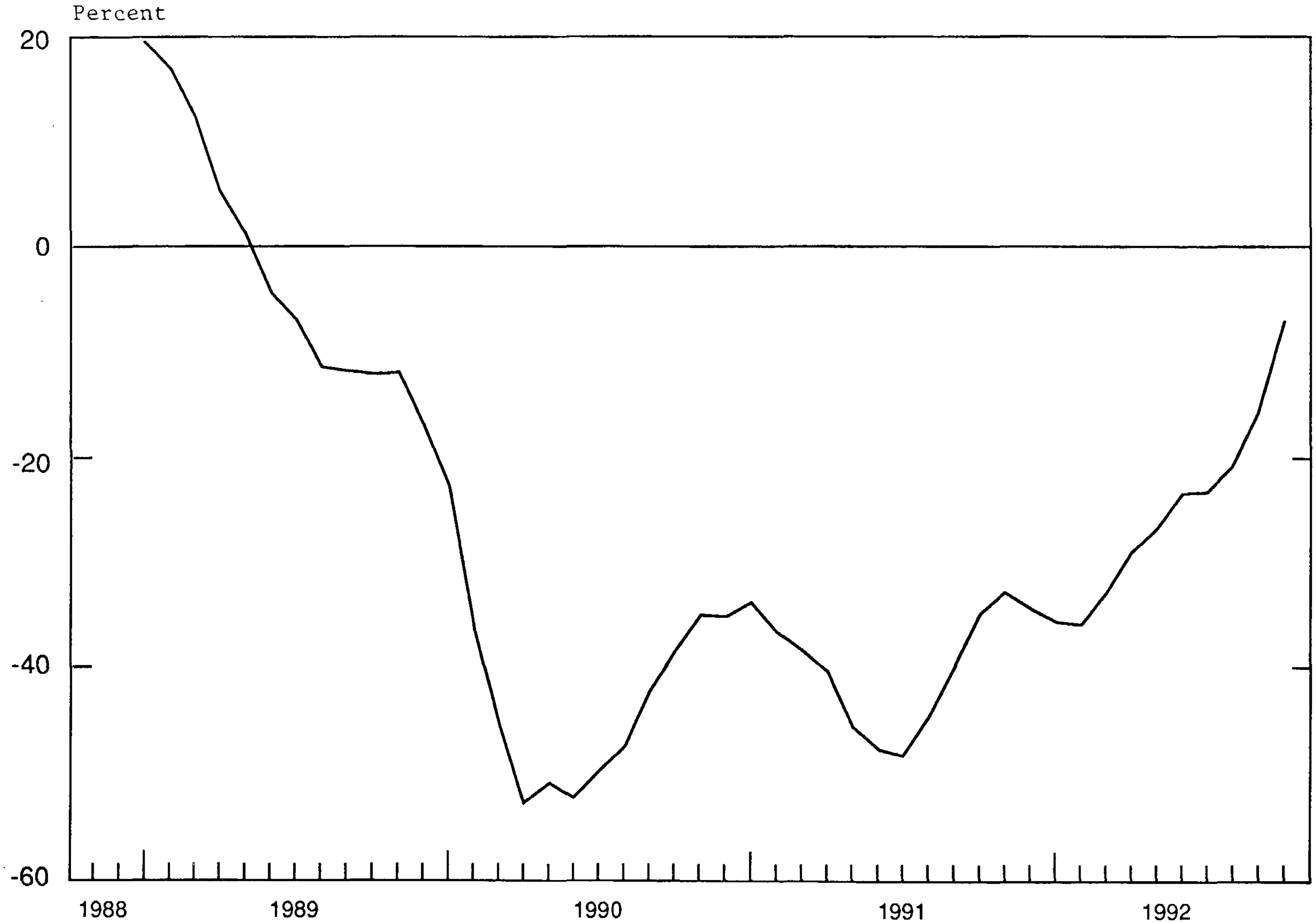
Sources: Data provided by the Polish authorities; IMF Information Notice System; and staff estimates.

Chart 2
POLAND
OUTPUT, TRADE, AND STATE BUDGET, 1991-92



Sources: Data provided by the Polish authorities; and staff estimates.

Chart 3
Poland
General Business Indicator[1]



Source: Research Institute of Economic Development, Warsaw School of Economics.
[1] *Business Survey*, based on the balances of assessment of the current and forthcoming volume of production.

increases in some turnover taxes and lower-than-projected enterprise profits. Although the revenue shortfall occurred throughout the year, budgeted expenditures, including 1 percent of GDP for the repayment of arrears, were heavily backloaded to the latter half of the year. Also contributing significantly to the fiscal deterioration towards the end of the year were: postponed indexation adjustments to government salaries (whose real value had been eroded by almost 50 percent since the last adjustment) and to pensions; and a number of once-off operations.

The deterioration in the fiscal situation is worrisome. The authorities estimate that deficits of 7-8 percent of GDP could raise inflation back to near triple digit levels within about a year. It would also lead to rapid increases in the public debt and in debt servicing costs, to a crowding-out of the investment needed for sustained growth, and to the loss of credibility and confidence. The new government thus declared early on its intention to rein in the state budget deficit. Specifically, it is to remain unchanged in nominal terms at Zl 81 trillion (Zl 82 trillion on the staff basis) and, thereby, to decline to 5 percent of GDP. 1/ This is expected to permit (12-month) inflation to slow from some 47 percent during 1992 to 32 percent during 1993.

Even given these objectives for financial policies, it is difficult to assess the net impact on developments in 1993 of the forces currently at play. Perhaps the most adverse factor is the international environment, notably the weakening of demand in Germany, Poland's main trading partner. The impact of fiscal consolidation might also be adverse as the negative demand effects could outweigh the positive supply effects in the short run. Here, however, there is room for doubt since, while the target fiscal deficit for 1993 (as a ratio to GDP) represents a significant improvement over the likely 1992 outcome, it means in effect that the deficit returns to the levels observed in the first half of 1992 (Chart 2)--a period of surging activity even though fiscal policy was relatively constrained. Finally, there are the more clearly positive considerations. Several of the factors restraining demand (for example, the decline in real wages) and supply (the drought) in 1992 should be absent next year; and, most important, the momentum evident in 1992 should carry over into 1993 as there is no reason to suppose that the favorable supply-side effects observed in 1992 should not continue even if in attenuated form. 2/

In framing their policies for 1993, the authorities opted for a cautious framework of assumptions (Table 1). Growth is projected to rebound from -1 percent in 1992 to +2 percent, a view shared by the staff--if

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1/ The estimates in percent of GDP are subject to revision since the errors associated with estimates of the level of nominal GDP are large, easily 10 percent.

2/ The most recent business survey conducted by the Warsaw School of Economics shows a rising trend in both domestic and export new orders, which should help to sustain the recovery in 1993.

anything the staff regards the estimated decline for 1992 as pessimistic. 1/ The balance on external current account is expected to remain broadly unchanged from its level in late 1992, implying a slight deterioration year-on-year, but reserves are projected to increase by about US$200 million.

III. Policies

The discussion with the authorities focussed on two aspects: first, as already noted, on the need to rein in the fiscal deficit, both to free resources for investment and to establish a stable financial environment; and second, as emphasized in previous reports, 2/ on the need to complement stabilization policies by structural reforms if macro stabilization is to be lastingly successful. Specifically, the staff report and the summing-up for the most recent Article IV consultation underlined the importance of reforms in three critical areas: measures to strengthen the revenue base of the budget, which is at risk as a result of the deteriorating financial situation of state enterprises and the difficulty of taxing the private sector; measures to limit and rationalize the explosion in entitlements payments, which rose from 10 percent to 20 percent of GDP from 1989 to 1992; and measures to strengthen the functioning of state-owned enterprises, notably through actions to improve corporate governance and the functioning of financial markets.

1. Fiscal stabilization and reform

The 1993 state budget is premised on a deficit of 5.0 percent of GDP, as compared to 7.8 percent of GDP in 1992 (measured on a domestic commitments basis). Levels of government outside the state budget are expected to register a surplus equivalent to about 0.4 percent of GDP. Thus, the deficit of the general government is to be reduced from about 7.2 percent of GDP in 1992 to 4.7 percent in 1993 (Table 2). The arrangement permits this deficit to rise to perhaps 5 1/2 percent of GDP in 1993 in the event that two externally financed projects reach the disbursement stage or agreement is reached with foreign commercial bank creditors (see Appendix A of the Memorandum of the Government of Poland on Economic Policies (EBS/92/219, 12/22/92).

As shown below, the extent of the adjustment in terms of policy measures built-in to this budget is considerably greater than the correction in the state budget deficit suggests--5.4 versus 2.8 percent of GDP.

1/ This decline is premised on: (a) a sharp drop in agricultural output on account of the drought; (b) developments in industry, trade, and construction that the staff views as cautious relative to developments in short-run indicators; and (c) a 6 percent fall in the output of the "non-material-services" sector, which has a 15 percent weight.

2/ For Poland, see SM/92/139 (7/9/92); for Eastern Europe generally, see SM/92/132 (7/30/92).

	1992 Estimate	1993 Budget	1993 Of Which: Measures
	(In percent of GDP)		
State budget revenues	26.4	26.7	1.0
Turnover taxes/VAT	9.2	11.4	1.5
Of which: import surcharge	(...)	(0.8)	(0.8)
Personal income taxes	6.0	6.7	0.1
Enterprise income taxes	4.2	3.6	-0.2
Excess wage taxes	1.5	0.5	n.a. 1/
Other	5.7	4.5	-0.4
Of which: dividend requirement	(0.7)	(0.4)	(-0.4)
State budget expenditures 2/	34.3	31.7	4.4
Transfers to social insurance funds	7.9	8.1	2.1
Interest expenditures	3.0	3.8	...
Other current expenditures	20.5	18.3	2.1
Of which: gross wage bill	(6.8)	(6.2)	(0.6)
Capital expenditures and net lending	1.6	1.4	0.2
Extrabudgetary expenditures 3/	1.3	0.1	...
State budget balance	-7.8	-5.0	
Total measures	...	...	5.4

On the revenue side, the stability of the ratio to GDP masks a marked rise in indirect tax rates and a broad array of structural reforms (including enhanced tax administration) intended to offset the on-going secular erosion of the tax base and the impact of systemic changes in income policies. Statutory turnover tax rates were raised by 3 percentage points on average and a temporary 6 percent surcharge on imports was introduced as of early December 1992. 4/ As regards the personal income tax, the indexation of the brackets was suspended, tax withholding was reformed to reflect taxpayer liability more accurately, and the top marginal rate was raised to

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1/ The excess wage tax is a regulatory device and hence changes in the revenue yield cannot be readily interpreted as a tax measure.

2/ On a domestic commitments basis, i.e., external interest payments are on a cash basis.

3/ In 1992, these represent once-off expenditures.

4/ The temporary import surcharge is seen as necessary since any increases in the fiscal deficit beyond targeted levels would have adverse implications for a balance of payments that affords little room for maneuver over the medium-term (see below). In addition, the authorities have noted that the unusually severe drought has had a negative impact on the balance of trade.

50 percent. 1/ However, overall enterprise taxation, particularly for state enterprises, was lowered somewhat to provide resources for investments and clarify the incentives for state enterprises. 2/ The tax measures are complemented by a range of actual or pending structural reforms intended to strengthen current and future state revenues. Foremost among these is the introduction of the VAT. The law has been approved by the lower house of Parliament, and implementation is planned for mid-1993. (For the other measures, see ¶14, ¶15 of the Memorandum of the Government of Poland on Economic Policies) 3/.

On the expenditure side, a key feature of the budget is the expected stabilization (as a percent of GDP) of the state's support for entitlement expenditures. This would represent a marked break from recent experience. One of the main measures is the proposal to implement a permanent 9 percent cut in the real value of pensions at the time of the next indexation adjustment, expected in June 1993. 4/ This provision would save about 2/3 percentage points of GDP in 1993 (and 1 1/3 percentage points on an annual basis). The staff emphasized the need for a comprehensive approach to pension entitlements, one that would clearly link benefits to contributions and ensure the financing of the system in the longer term. The authorities agreed, but stressed the difficulty of achieving political agreement on technically clean solutions. Nonetheless, financial realities gave them no option but to press ahead, along lines they thought might be politically feasible. In this vein, they were preparing a bill to curtail sharply the eligibility of various occupations (comprising 20 percent of the work force) for early retirement. Significant savings in 1993 were also expected on family allowances (which were to be frozen in nominal terms for the second year in a row), unemployment benefits (where eligibility was now generally limited to 12 months and payroll contributions raised from 2 percent to 3 percent), and sickness benefits (where the private sector was now also expected to pay for the first 35 days of sick-pay).

While the adjustment underlying both the revenue and entitlements estimates is considerable, it nevertheless does little more than stabilize the corresponding ratios to GDP. The correction in the fiscal deficit thus also requires a significant adjustment in the rest of the budget, especially in current expenditures excluding interest and transfers to the social insurance funds. On a commitment basis, these are to decline from 20.5 percent to 18.4 percent of GDP. The two principal measures here are: a 5 percent reduction in the "person year" ceilings of ministries, which is

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1/ The motivation of the last measure was in part to make the proposed cut in pensions more acceptable.

2/ In particular, the dividend requirement on state enterprises, a tax that bore little relationship to the (economic) capital stocks or the profitability of enterprises, was abolished.

3/ Hereafter, all paragraph number citations refer to this Memorandum.

4/ Although initially rejected, this proposal has now received a positive first reading in Parliament.

expected to translate into a 2-3 percent reduction in hours worked, with the balance being a de facto drop in real wages in the budgetary sphere (through curtailment of bonuses); and the centralization of public procurement with the associated introduction of competitive bidding. These general measures are complemented by a variety of ministry-specific measures (¶20).

Is the budget realistic? It is most difficult to assess the realism of the substantial planned reduction in discretionary current expenditures; this area is, however, where budgetary control is firmest and the authorities' record the strongest. The staff considers the estimates for entitlements to be broadly realistic, but it does have concerns that interest expenses may be underestimated. Against this, however, the staff views the revenue estimates as possibly conservative, with upside potential being greater than downside risk. The margin of error regarding the effects on 1993 revenues of shifting to the VAT is evenly distributed, but large. 1/ Untoward developments would trigger compensatory measures (¶11).

2. Monetary and financial stabilization and reform

Monetary policy in Poland has been conducted against the background of a crawling peg exchange rate arrangement. 2/ Therefore, taking account of the likely behavior of the demand for money, attaining the inflation and international reserve targets has meant that limits need to be placed on domestic credit expansion. Attaining these limits has been complicated, however, by the need to finance a large budget deficit.

Broad money in 1992 is projected to increase several percentage points faster than initially programmed, raising the question whether policy has been accommodative and whether the rise in inflation during the second half of the year reflects too much money chasing too few goods. An accommodationist interpretation is, however, difficult to reconcile with the exogenous role of the drought in the spurt in inflation, the generally positive level of real interest rates, the considerable rise in international reserves, and the associated strength of the zloty in the free market following the step devaluation in February (Chart 1). On balance, the authorities felt that during 1992 monetary policy had kept things on a

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1/ The experience of other countries on the revenue impact of the VAT in the first year has been mixed, with the outcome being influenced to a large degree by the extent of administrative preparation preceding the introduction (see Value-Added Tax: Administrative and Policy Issues, Occasional Paper, No. 88, IMF, October 1991).

2/ As the rate of crawl has been preannounced and steady, this regime is analytically equivalent to a fixed exchange rate regime.

more-or-less even financial keel despite the large fiscal deficit, a task assisted by the weakness of credit to enterprises (including interenterprise credit). 1/

Monetary policy will be tightened in 1993 to be consistent with a much lower rate of inflation (32 percent through the year) (Table 3). The present rate of crawl in the exchange rate, 1.8 percent per month, is to be maintained, which is appropriate in light of recent productivity trends and the real wage developments targeted in the program. 2/ Given the international reserve target and likely behavior of money demand, credit again needs to be tight. 3/ It will also be critical for the authorities to pursue a flexible interest rate policy to ensure an efficient allocation of the available credit and to underpin the crawling-peg arrangement.

With this in mind, the NBP intends as of early 1993 to shift away from existing instruments of direct monetary control, notably the use of bank-specific credit ceilings (which in the future would only be used in emergencies), and to rely instead on indirect instruments, especially open market, including reverse repurchase, operations (¶28). Accordingly, steps are planned to strengthen the institutional framework, to broaden the market for government paper, and widen the array of instruments available to the central bank. These measures build on the progress made in modernizing the financial markets over the last three years, in good part because of extensive technical assistance, including from the Fund.

The staff supported the monetary policy objectives for 1993 and welcomed the structural advances in the monetary and financial field, but expressed concern on several points. One concern was the potential for constraints on interest rate policy arising from the desire to limit interest rate increases so as to contain the cost of servicing public debt and to stimulate investment by state enterprises. Insofar as inflation declined smoothly, these constraints would likely not prove problematic given the caution with which the NBP had acted in the past. If inflation proved more deep-seated than thought, however, the reluctance to see rates rise would vitiate the authorities' commitment to move to open market operations. In

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1/ Interenterprise credits, as measured by gross payables due arising from supplies of goods and services, increased from Zl 162 trillion at end-January 1992 to Zl 197 trillion at end-September 1992; this change is equivalent to an increase of 1.5 percent in real terms using producer prices as the deflator. Data on the proportion of these credits representing arrears or involuntary lending are not available.

2/ The ratio of Poland's unit labor costs to that of its major partners in the first three quarters of 1992 was 12 percent lower than in 1991. This ratio is expected to remain broadly unchanged under the program.

3/ The program allows for a small decline in velocity, in line with a cautious interpretation of recent tendencies and prospects; the growth of broad money is therefore targeted to be 37 percent.

the staff's view, the only sure way of reducing interest rates was to reduce inflation, a step which might, however, require a temporary rise in interest rates.

Another concern was the crowding-out of the nongovernment sector from credit markets despite the planned reduction in the fiscal deficit. Including so-called directed credit, government would still account for about two thirds of domestic credit in 1993. In this regard, the staff stressed the need to scale back the preferential treatment of housing and agriculture under the directed credit programs. Given the attractiveness of government paper, however, the crowding-out issue would need to be addressed mainly through further reductions in the government deficit. Concerns on this score were compounded by the very short-term character of the public debt. The bulk of it is in short-term (2-3 month) treasury bills. As a result, the asset side of banks' balance sheets is quite liquid--a matter that would become of considerable concern if, as should be expected over the next few years, strong and viable credit demands emerge from the enterprise sector. The NBP and the Government have been addressing this issue, but progress is slow, in part because of a reluctance to agree to the better terms investors expect of longer-term paper.

3. Reforming the state enterprise system

The deterioration in the conditions of state enterprises has been marked. Although much of this is generally viewed as having been unavoidable, the Government itself has also on occasion been charged with (or defended against the charge of) negligence, political ambivalence regarding privatization, or political helplessness in the face of local resistance and enterprises that were de facto under the control of their Workers' Councils. To their credit, successive Governments did elaborate comprehensive procedures to facilitate the "ownership transformation" of state enterprises and were quite persistent in their efforts to control wages in an attempt both to simulate hard budget constraints in, and to protect the net worth of, state enterprises. Nonetheless, successive Governments have generally failed to provide the positive and tangible guidance and leadership as to what enterprises should do if they were to become active and positive forces in the transition process. As a result, progress toward improved corporate governance has been mostly a matter of local initiative, albeit hastened in a not inconsiderable number of cases by liquidation and bankruptcy proceedings (¶49).

The new Government is changing this: the transformation of the state enterprise system is its top structural reform priority. This commitment is embodied in the so-called "Pact on State Enterprises", the umbrella for several pieces of legislation that represent a complex and manifold effort to wrest control of state enterprises from the Workers' Councils, to put enterprises on the road to rapid privatization, and to keep control of wages while preserving social peace and strengthening labor relations.

The main feature is mandatory ownership transformation. All state enterprises except those in the most strategic and problematic sectors and those already selected for mass privatization (¶39) must opt within six months of the passage of the legislation for either commercialization (joint-stock status), privatization, or liquidation (including buy-outs). 1/ Otherwise, the enterprises in question forfeit the right to choose their transformation path to the Ministry of Privatization or its founding body.

The change in the legal status of enterprises is accompanied by a change in the locus of effective control. For instance, for enterprises that opt for something less than immediate privatization (e.g., joint stock company status), provision is made to limit employee representation on the company board and to give management performance incentives that can range up to 15 percent of equity. At the same time, the Pact defines and protects certain employee rights. For instance, employees will receive 10 percent of the shares free of charge and, in larger enterprises, have the right to nominate a third of the directors. Separately, new legislation will ensure the continuance of the enterprise social funds and establish a wage guarantee fund to protect for a three month period the wage payments of recently liquidated or bankrupt enterprises (¶47,¶48).

Can the envisaged acceleration in the pace of ownership transformation be realized? The authorities acknowledged that there would likely be considerable initial turmoil and confusion as thousands of enterprises came to grips with the process; but this was to be viewed as an unavoidable and indeed useful part of the process of forcing state enterprises to come to grips with the fundamentals of their situation. The authorities also stressed, however, that they were perhaps better prepared to assist in the transformation process than might appear at first sight: the Pact had been in good part designed to make best use of policies and procedures that had been long in the making and were now nearing fruition. Two aspects were especially important.

First, the <u>facilities and procedures for ownership transformation</u> now provided for in Polish law or established by the relevant ministries, notably the Ministry of Privatization, are well developed. These cover every aspect of the economy, from the largest state enterprises to state farms to municipal utilities, and all forms of "ownership transformation", from public offerings to joint-stock companies to bankruptcy. The authorities emphasized that the process of ownership transformation was now clear and transparent: indeed, the procedures had already effected considerably more transformation than was often realized (¶2,¶49). They

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1/ Those enterprises with particularly intractable problems (for example, the coal and steel industries) will be the focus of Poland's industrial policy efforts to facilitate their adjustment (i.e., down scaling) to the changed economic environment. The budget provides for subsidies equivalent to about 0.1 percent of GDP for industrial policy.

were therefore confident that every state enterprise affected by the Pact would not only know where to go for help and advice, but would also receive it. As regards mass privatization, this had been one of the first pieces of legislation forwarded by the Government to the Parliament; they hoped it would be approved by March 1993 (¶51). 1/ Asked whether the Pact had not diminished the attractiveness of mass privatization for the enterprises involved, the authorities thought not: the large enterprises already selected felt that the mass privatization route was suited to their needs, particularly because it provided direct access to skilled advice (via the investment funds); moreover, the Pact was giving new life to the process of privatization, which would hasten the passage of the mass privatization law. In this connection, it was noted that the participants (restricted to adult Poles) would now be required to pay a small charge for their vouchers, an adaptation that reflected experience in Czechoslovakia 2/; the Polish mass privatization program retained, however, its distinguishing feature of ensuring that effective control over the companies was relatively concentrated (¶51).

Second, a program of financial restructuring and bad loans work-out has been elaborated with the World Bank (¶42-¶45 and Supplementary note 4 of SM/92/139). This is a cautious scheme whereby the nine main state banks are to work-out their bad loans on a case-by-case basis within a market-oriented structure that seeks to balance the incentives and disincentives of the various participants. The quid-pro-quo for the banks is a recapitalization by the state sufficient to bring the capital-asset ratio to 12 percent. 3/ This scheme should effect a major and lasting improvement in Poland's credit and financial markets. But it will also provide the avenue for potentially viable state enterprises to establish, together with their bank, the financial restructuring plan necessary to give meaning to ownership transformation--i.e. the positive net worth necessary to ensure that ownership transformation results in positive rather than negative market

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1/ On this timetable, the twenty National Investment Funds, which would hold 60 percent of the shares in those companies slated for mass privatization, would become operational in July 1993 and, following registration of interested eligible citizens, shares in the funds would be distributed in early 1994.

2/ An exception would be in the case of those vouchers (backed by about 200 enterprises) that would be distributed to those eligible for compensation following the Constitutional Tribunal decisions declaring a number of measures contained in amendments to the 1991 Budget Act to be unconstitutional.

3/ Under this program the following elements are expected to be completed by midyear: adoption of the Enterprise and Bank Restructuring Law; finalization of the amount and modalities of bank recapitalization; specification of actions to be taken by the commercial banks regarding the loan work-out departments; specification of the conditionality governing eligibility for government intervention; and development of a detailed plan to strengthen bank supervision.

incentives. The staff's main concern with the project was whether the authorities were not underestimating the size of the bond issue needed for the recapitalization, which was estimated at less than 2 percent of GDP. The authorities thought not; in any case, the recapitalization would be based on audits of the positions of banks as of mid-1992, the results of which would be available by the turn of the year.

The other main dimension of the Pact on Enterprises is its implications for incomes policy and labor relations more generally. This has been a matter of some concern given the insistence of the unions on eliminating the "popiwek", the tax on wages that exceed the norm. While financial constraints on most state enterprises are now such that the scope for an escalation in excessive wage increases is much diminished, the elimination of the "popiwek" would nonetheless create considerable uncertainty as to the likely course of wages under the program. Such concerns would appear to be misplaced, however. The Pact provides for the establishment of an advisory Tripartite Commission designed to involve the social partners in the wage determination process and labor relations more generally, but with the Government having the final say as regards permissible increases in wages in state enterprises (¶41). The excess wage tax will be retained, albeit with somewhat softened marginal rates and inducements for firms to link bonuses to profits (¶35). The bottom line, however, is that the system remains quite restrictive. The loss of revenue from the excess wage tax expected for 1993 (Table 2) reflects primarily the weakened financial condition of enterprises, the new guidelines on wages policy, and the effects of privatization.

4. Exchange and trade arrangements

Trade policies and exchange system reforms in 1993 are aimed at furthering Poland's integration into the world economy. The highly efficient nonbank foreign exchange market ("kantor market") will be preserved during 1993 in its current form, while the official foreign exchange market will be deepened through various measures (¶56,¶57). The Government also intends in 1993 to remove the remaining restrictions on current account transactions--including allowing the repatriation of profits and capital in certain portfolio investments. Over time, the freeing of the official market should permit the elimination of the current multiple currency practice. In the meantime, however, the authorities will continue to limit the spread between the official and the kantor market rates, as they have done quite successfully during 1992, through appropriate policies.

The Government is committed to a long-term strategy of lowering barriers to trade. It is pursuing bilateral negotiations with concerned trading partners with a view to agreeing on a new protocol of accession to the GATT that reflects Poland's status as a market economy. In particular, to replace quantitative commitments on import growth under the old protocol, Poland proposes to bind the majority of its tariffs under a new protocol. In this context, the additional turnover border tax is strictly temporary and the Government is committed to reducing it to 3 percent in 1994 and to eliminating it in 1995 (¶59). The implementation of the free trade agreement with the EC is proceeding on schedule, while similar agreements are expected to be implemented shortly with EFTA and Hungary and Czechoslovakia (or its successor states) (¶60). For the time being, and for lack of alternative instruments, the authorities will temporarily maintain a few quantitative import restrictions (mainly on fuels, tobacco and spirits) pending the restructuring of the domestic fuel industry and the strengthening of border tax administration (through banderoles etc).

IV. Medium-Term Outlook and Capacity to Repay

In designing a scenario for the medium term, the staff's premise is that the conditions for sustained positive growth are present, provided that the authorities adhere to a strong stabilization and structural reform program. In this regard, the emphasis of policies needs to shift from containing domestic demand to fit a shrinking effective capacity to supply to strengthening supply so as to keep it ahead of a rising domestic demand. In this, sharply higher rates of productivity growth and savings and investment will be essential.

Recent and prospective developments would appear to be reasonably auspicious in this respect. With output in industry rising by some 8 1/2 percent and employment falling by 8 percent (third quarter, 1992 over third quarter, 1991), productivity increased sharply during 1992. In tandem with a firming in private savings--variously ascribed to increased uncertainty (presumably a temporary phenomenon) or the widening of differences in the distribution of income (presumably more permanent)--and continuing weakness in investment spending, this led to a sharp narrowing in Poland's current account deficit despite the upturn in activity and the increase in public dissaving.

The outlook is also favorable. A key element here is the reduction in public dissaving embodied, in the first instance, in the authorities' commitment to reduce the state budget deficit to 5 percent of GDP in 1993, and, in the second, in the intention to cut the deficit by a further 1 percentage point in 1994 (¶12) and to limit the growth of consumption to half that of GDP in the medium term (¶41). 1/ The latter implies a significant growth in investment in both the private and public sector, where it is expected to account for an increasing proportion of the fiscal deficit.

1/ The importance of the reduction in public dissaving is underscored by the fact that the surge in nongovernment savings in 1992, which may reflect precautionary behavior in the light of uncertainty concerning policies, cannot be depended upon to persist. Instead, the scenario adopts the conservative approach of assuming a fall back in savings based on the life-cycle consideration that the prospect of enhanced future living standards associated with appropriate policies would encourage consumption smoothing behavior.

This objective will be facilitated by a reduction in the burden of domestic debt service over the medium term arising from declines in inflation and, hence, interest rates. In tandem with increases in efficiency stemming from the redeployment of a well-educated labor force, these developments are expected to permit a gradual firming of growth to a 5 percent rate in the second half of the decade without undue strains on the balance of payments or excessive reliance on foreign savings.

The balance of payments projection for 1993, abstracting from a possible commercial bank debt and debt service reduction operation, is based on a cautious interpretation of these developments (Table 4). In the near term, in particular, some weakening in the trade accounts is envisaged, reflecting carryover effects of the drought into 1993 and the likely weakening in economic activity in Poland's most important trading partners. However, with fiscal consolidation gradually taking hold and with the steady improvement in the functioning of the supply side of the economy, this deterioration is likely to be modest--the staff projects that the current account deficit in 1993 will be about US$500 million. Allowing for identified inflows of medium- and long-term loans (mostly from the World Bank and other official multilateral institutions), amortization payments falling due, unchanged levels of direct foreign investment, and short-term capital outflows consistent with the experience in recent years, 1/ an increase in net international reserves of US$200 million is projected for 1993 with no financing gap.

The staff scenario of the balance of payments for the medium term, shown in Table 5, assumes an illustrative market-based debt reduction operation with commercial bank creditors in the second half of 1993 which is partly financed by Poland's own reserves. 2/ In addition, the scenario incorporates the completion of the second tranche of debt reduction under the Paris Club agreement in 1994 as well as agreement on a "zero option" package with Russia involving cancellation of mutual claims and liabilities

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1/ Some elements of short-term capital flows, e.g., "interbanking operations", have been persistently negative since 1990, but the underlying dynamics are not well understood. It is expected that, with the strengthening of the institutional framework of the financial sector, these elements will gradually become smaller and be classified in the proper transaction items. In 1992, the negative elements of the short-term capital account were more than offset by foreign exchange purchases in the kantor market by commercial banks (the counterpart to the latter inflow is an increase in reserves). In 1993, purchase or sale of foreign exchange by banks in the kantor market is assumed to be absent.

2/ The authorities are preparing a proposal to present to the steering committee of banks in early 1993. Meanwhile, for illustrative purposes, the scenario assumes a menu of options including a buyback, discount bonds, and par bonds in equal proportions and equivalently priced. The scenario also assumes additional financing from official multilateral institutions in partial support for the costs of a debt operation.

denominated in convertible and nonconvertible currencies. While the projections indicate that there is little room for maneuver, in particular as debt service obligations increase sharply when the five year grace period associated with the Paris Club agreement runs out, and continue to rise well into the next decade, there are no financing gaps and the path for official reserves implies import coverage in 2000 of over three months.

On the capacity to repay the Fund, Poland's repayment obligations to the Fund based on the proposed arrangement have been incorporated in the medium term balance of payments scenario, and are shown in Table 6. The bulk of the obligations under previous arrangements as well as under the proposed stand-by arrangement fall due during 1994-98, a period which coincides with a projected build-up of reserves. The various measures of debt and debt service obligations, including to the Fund, point to a manageable situation: at the peak in 1994, repurchases and charges would represent about 2 percent of exports of goods and services, 14 percent of total debt service obligations (assuming a reduction in those obligations in line with the assumed outcome of the commercial bank debt reduction operation) and 9 percent of gross official reserves. The main risks to this outlook--abstracting from a breakdown in policy implementation--are: (i) the failure of CMEA trade to grow as projected; and (ii) the need for greater-than-envisaged imports for economic reconstruction. On the positive side, however, foreign investment could be much larger than projected if the economic program is adhered to and if the authorities take further measures to improve the investment climate.

V. Features of the Proposed Stand-By Arrangement

The quantified criteria for monitoring performance under the program are: (i) limits on the cumulative deficit of the general government; (ii) limits on the stock of net domestic assets of the banking system; (iii) limits on the stock of net credit of the banking system to the general government; (iv) targets for the minimum levels of net international reserves in convertible currencies of the banking system; and (v) limits on the contracting or guaranteeing of new nonconcessional external debt. These performance criteria have been established for March and June 1993; indicative limits have been set for September and December 1993. The criteria are spelled out in detail in appendices to the Memorandum of the Government of Poland on Economic Policies. 1/ The customary clauses on overdue financial obligations to the Fund, no accumulation of external payment arrears, excluding debts currently under renegotiation; and on exchange restrictions,

1/ The limits on external debt apply to debt with an original maturity of more than one year and up to and including 12 years. In the absence of effective monitoring mechanisms, limits have not been set for short term debt or on debt with maturity between one year and five years. A comprehensive public debt monitoring system will be established within the Ministry of Finance, which over time should also monitor short-term debt.

multiple currency practices, bilateral payments agreements inconsistent with Article VIII, and import restrictions for balance of payments purposes, are also applicable as performance criteria during the period of the arrangement.

Once an agreement with commercial bank creditors is finalized, the first four performance criteria listed above will be reconsidered to allow for any additional net costs related to debt reduction operations. The performance criteria have been designed to allow for interim payments arrangements, to be decided through negotiation, prior to the finalization of an agreement. Progress in reaching a satisfactory agreement with commercial bank creditors will be reviewed prior to each purchase under the arrangement. Twenty five percent of each purchase under the arrangement is to be set aside for operations involving a reduction of principal. The authorities have also indicated that when negotiations with commercial banks have been completed they intend to request an augmentation of the arrangement for interest support or to collateralize principal in reduced-interest par bond exchanges in connection with debt and debt service reduction operations.

Two reviews with the Fund to assess developments under the program are provided for. The timetable of these reviews and the phasing of purchases are set out in Table 7. The first review, to be completed before August 15, 1993, will give particular emphasis to progress in implementing the value-added tax, the steps taken to curtail transfers to the social insurance funds (such as the proposed rebasing of pensions), the effectiveness of wage policy, and the progress with structural reforms, especially privatization and other features of the Pact on State Enterprises. The second review, to be completed before February 15, 1994, will consider, inter alia, the budget for 1994 and the agenda for further structural reforms, especially measures of a longer term nature to strengthen public finances, and progress in phasing out the import surcharge.

Paris Club creditors have communicated to the Polish authorities that they are ready in principle to consider a modification of the April 1991 agreement. The proposed modification would allow for the implementation of the second tranche of debt reduction and reorganization as of April 1, 1994, provided that a stand-by arrangement ending no earlier than March 15, 1994 is in place and Poland strictly adheres to the conditionality under such an arrangement, and in particular successfully concludes the scheduled reviews under the arrangement.

VI. Staff Appraisal

Poland's transformation to a market economy has proved more arduous and drawn out than anticipated. The decline in output in the first two years of the program, which with the benefit of hindsight was likely largely unavoidable, was dramatic. In addition, building the institutions that underpin market economies has proven to be difficult and time consuming. However, despite adversity, successive Governments have persisted with the reform effort. And much has been achieved. The private sector has expanded rapidly to the point where its growth now has a major influence on that of total output. Indeed, the recent turnaround in economic activity owes much to this development and offers the prospect that Poland can attain a path of sustained growth with reduced inflation.

However, even with the improvements to the supply side of the economy, Poland must still address a number of interrelated policy issues. In particular, a dual economy has emerged in Poland. On the one hand, there is the rapidly growing private sector. The fundamentals of this sector appear sound and there is little reason to doubt that the growth of this sector will be sustained over the medium term if the authorities preserve financial stability. On the other, there is the shrinking state enterprise sector. Here, the government and the increasingly disaffected state enterprises are bearing the brunt of the costs of the transition, costs which have been magnified by structural weaknesses and indecision and which threaten the stability achieved thus far.

The Government's program should be seen as an appropriate step toward dealing with this situation, both in 1993 and over the medium term. The commitment to reduce the budget deficit to 5 percent of GDP ensures financial stability and further progress on inflation; the associated policies of fiscal reform go far toward redressing the underlying medium term budgetary trends without undermining the incentives of the private sector; planned monetary and exchange rate policies are suitable for achieving the objectives of the program; and the shift to indirect instruments of monetary control should facilitate a more efficient allocation of available credit. The actions taken to strengthen ownership transformation and the functioning of financial and labor markets will serve both to safeguard the state's existing assets and, more importantly, to transform them from being a drag on, to being contributors to, the transition process. Over the medium term, these policies hold the promise of stimulating supply-driven growth, with exports and nondebt creating flows rising fast enough to finance the imported investments required for growth and external debt servicing obligations.

These are policies that the staff, and the Executive Board, have previously recommended to the authorities. Accordingly, the staff considers the authorities' program as fully deserving of being supported by a Fund arrangement.

Needless to say, there are risks. These include:

- forecasting risks: the variance attaching to the path of output, inflation, or reserves is large, and major deviations in an untoward direction could cause significant problems for the program;

- implementation risks: the tight cash limits for discretionary expenditures could lead to arrears (which are difficult to control) and, while real interest rates remain marginally positive on an ex ante basis, the authorities could face circumstances where they would need to raise these rates. More generally, a successful shift to indirect instruments of monetary control would be predicated on the authorities tolerating greater interest rate flexibility;

- reform risks: the introduction of the VAT could engender start-up losses in revenue, beyond those allowed for, while the Pact on Enterprises could face slippages or provoke unwarranted increases in real wages and/or major labor shedding; and

- political risks: the Government does not have a majority in Parliament so that--despite the passage of the so-called "small constitution" and although the Parliament is more accepting of budgets than day-to-day political byplay and headlines might suggest--the economic program is subject to potentially significant revisions. Moreover, there must always be some question about the durability of a coalition government based on seven parties.

That being said, the staff would nevertheless judge the risks to be acceptable. In formulating the economic program with the authorities, care has been taken to minimize those risks over which there can be some ex ante control. Of course, developments ultimately will depend on the determination of the authorities to carry through with the program. In this, the staff has no reason to doubt the authorities' commitment to carry out the policy intentions laid out in the Memorandum on Economic Policies.

Poland continues to maintain exchange restrictions in accordance with Article XIV, including restrictions arising under certain bilateral payments agreements and on travel allowances and other invisible payments and transfers. In addition, the operation of the parallel exchange market gives rise to a multiple currency practice subject to approval under Article VIII, Sections 2(a) and 3. Given that with appropriate financial policies and some official intervention in the parallel foreign exchange markets deviations between private and official exchange rates have generally been less than 2 percent, and that the authorities intend to deepen the official exchange market to permit in due course the unification of the exchange system, the staff recommends temporary approval of the multiple currency practice.

VII. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

I. Request for Stand-by Arrangement

1. Poland has requested a stand-by arrangement for a period of 14 months in an amount equivalent to SDR 476 million.

2. The Fund approves the stand-by arrangement set forth in EBS/92/219, Supplement .

3. The Fund notes the intention of the Polish authorities to request augmentation of the amount of the stand-by arrangement as set forth in paragraph 1 above. The Fund will be prepared to consider such augmentation in the event that arrangements for the financing of Poland's program provide for appropriate debt service reduction and upon determination by the Fund that such arrangements are consistent with the objectives of the program.

4. The Fund waives the limitation in Article V, Section 3(b)(iii).

II. Exchange System

Poland maintains a multiple currency practice that arises from the operation of the parallel exchange market that is subject to approval under Article VIII, Sections 2(a) and 3. The Fund approves this multiple currency practice until March 31, 1994.

Table 1. Poland: Macroeconomic Framework, 1990-95 1/

	1990	1991	1992	1993	1994	1995
			(In percent of nominal GDP)			
Foreign savings 2/	-4.3	3.5	0.2	0.6	0.4	0.7
Gross national savings	31.8	18.1	18.8	18.7	20.5	21.8
Government	0.4	-6.8	-7.8	-4.2	-2.2	-0.6
Nongovernment	31.4	24.9	26.5	23.0	22.7	22.5
Gross domestic investment	27.5	21.5	19.0	19.3	20.9	22.5
Government	2.8	2.4	1.6	1.4	1.7	2.0
Nongovernment	24.7	19.1	17.4	17.9	19.3	20.5
Fixed investment	19.6	18.8	17.4	17.8	19.3	20.9
Change in stocks	7.9	2.7	1.6	1.6	1.6	1.6
General Government deficit						
Commitment basis	-2.4	-9.2	-9.4	-5.7	-3.8	-2.6
Cash basis 3/	3.1	-6.0	-8.1	-4.7	-3.8	-2.6
			(Percent change in real terms)			
Memorandum items:						
Gross capital formation	-37.6	-14.2	-4.3	7.6	11.9	12.2
Government	-21.8	-19.5	-26.5	-6.0	20.2	25.8
Nongovernment	-39.7	-15.3	0.1	8.8	11.3	11.1
Fixed capital investment	-10.6	-4.5	--	8.1	12.6	12.8
Consumption expenditure	-11.7	3.3	0.9	0.8	1.5	2.4
Government	-3.4	-6.5	-4.9	-1.2	1.5	2.4
Nongovernment	-13.7	7.4	3.1	1.5	1.5	2.4
GDP	-11.6	-7.2	-1.0	2.0	4.0	5.0
Nominal GDP (in trillions of zlotys)	592	824	1,150	1,625	2,101	2,414

Sources: Data provided by the Polish authorities; and staff projections.

1/ Assumes implementation of a debt and debt-service reduction operation with commercial bank creditors in 1993, and the completion of the second tranche of the Paris Club debt reduction in 1994.
2/ External current account deficit (+).
3/ Including domestic arrears.

Table 2. Poland: Government Finances, 1991-93

	1991	Budget 1992	Revised Budget 1992	Staff (Proj.) 1992	Draft Budget 1993
	(In trillions of zlotys)				
State budget revenues	212.6	337.7	306.6	304.9	433.5
Current revenues	210.9	327.7	300.6	298.9	424.7
Tax revenues	180.2	291.8	265.4	267.8	392.0
Turnover taxes	61.2	114.9	103.4	105.4	185.0
Enterprise income taxes	50.6	62.2	48.2	48.2	58.5
Personal income taxes	3.1	71.5	68.8	68.8	108.5
Tax on excessive wage increases	27.1	16.9	17.5	17.5	8.5
Customs duties	17.1	24.2	24.7	24.7	31.5
Other	21.1	2.1	2.8	3.3	--
Nontax revenues	30.7	35.9	35.2	31.1	32.7
Capital revenues	1.7	10.0	6.0	6.0	8.8
State budget expenditures 1/	254.5	392.2	377.9	378.6	514.5
Current expenditures	237.7	373.0	359.5	360.2	491.4
Transfers to the Social Insurance Funds 2/	43.6	95.6	90.1	91.1	130.9
Expenditures of budgetary units	146.9	192.7	187.6	188.1	249.3
Wage and wage related expenditures	60.5	101.0	103.4	103.4	134.6
Other	86.4	91.7	84.2	84.6	114.6
Interest expenditures	11.6	34.1	34.2	34.2	62.1
Other	35.7	50.5	47.6	46.9	49.1
Capital expenditures and net lending	16.8	19.3	18.4	18.4	23.1
State budget balance 1/	-41.9	-54.6	-71.3	-73.7	-81.0
Extrabudgetary expenditures	7.1	--	--	15.5	1.0
Full state budget balance 1/	-49.0	-54.6	-71.3	-89.2	-82.0
Change in outstanding domestic arrears	10.9	-10.9	-9.8	-9.8	--
State budget balance (cash basis)	-38.0	-65.5	-81.1	-99.0	-82.0
Balance of the rest of the general government	2.5	6.0	6.0	6.0	6.0
General government balance 1/	-46.5	-48.6	-65.3	-83.2	-76.0
General government balance (cash basis)	-35.6	-59.5	-75.1	-93.0	-76.0
Financing of the general government balance	35.6	59.5	75.1	93.0	76.0
Domestic bank financing	41.2	45.9	72.1	85.2	70.5
Domestic nonbank financing	0.8	10.0	6.0	6.7	12.2
Foreign financing	-0.9	3.6	-3.0	-3.0	-6.7
Other 3/	-5.3	--	--	4.1	--

Table 2 (concluded). Poland: Government Finances, 1991-93

	1991	Budget 1992	Revised Budget 1992	Staff (Proj.) 1992	Draft Budget 1993
			(In percent of GDP)		
State budget revenues	25.8	29.4	26.7	26.5	26.7
Current revenues	25.6	28.5	26.1	26.0	26.1
Tax revenues	21.9	25.4	23.1	23.3	24.1
Nontax revenues	3.7	3.1	3.1	2.7	2.0
Capital revenues	0.2	0.9	0.5	0 5	0.5
State budget expenditures 1/	30.9	34.1	32.9	32.9	31.7
Current expenditures	28.8	32.4	31.3	31.3	30.2
Transfers to the Social Insurance Funds 2/	5.3	8.3	7.8	7.9	8.1
Expenditures of budgetary units	17.8	16.8	16.3	16.4	15.3
Interest expenditures	1.4	3.0	3.0	3.0	3.8
Other	4.3	4.4	4.1	4.1	3.0
Capital expenditures and net lending	2.0	1.7	1.6	1.6	1.4
State budget balance 1/	-5.1	-4.7	-6.2	-6.4	-5.0
Extrabudgetary expenditures	0.9	--	--	1.3	0.1
Full state budget balance 1/	-5.9	-4.7	-6.2	-7.8	-5.0
Change in outstanding domestic arrears	1.3	-1.0	-0.9	-0.9	--
State budget balance (cash basis)	-4.3	-5.7	-7.1	-8.6	-5.1
Balance of the rest of the general government	0.3	0.5	0.5	0.5	0.4
General government balance 1/	-5.6	-4.2	-5.7	-7.2	-4.7
General government balance (cash basis)	-4.3	-5.2	-6.5	-8.1	-4.7

Sources: Data provided by the authorities; and staff estimates.

1/ On a commitment basis, except for external interest payments which are on a cash basis.
2/ Includes the Social Insurance Fund (including payments made to pensioners of the Ministry of Defense), the Social Insurance Fund for Farmers, and the Labor Fund.
3/ For 1991 represents unallocated financing; for 1992 represents sale of state treasury foreign exchange holdings.

Table 3. Poland: Monetary Survey, 1991-93

(In trillions of zlotys)

	Stock at End-1991	Flow Jan.-Sep. 1992	Stock at End-Sep. 1992	Flow 1992 (Proj.)	Stock at End-1992 (Proj.)	Flows in 1993 (Program) Q1	Q2	Q3	Q4	1993	Stock at End-1993 (Program)
Net international reserves 1/	71.3	46.0	117.3	48.4	119.7	4.2	13.7	12.2	3.6	33.7	153.0
(in millions of U.S. dollars)	6,505	1,926	8,431	1,370	7,875	-225	400	275	-250	200	8,051
Net domestic assets	189.7	54.1	243.8	95.6	285.3	31.6	19.8	28.4	36.5	116.3	402.0
Credit to nongovernment	193.6	37.1	230.7	50.0	243.6	13.5	15.0	19.0	19.5	67.0	310.6
Net credit to general government	88.3	62.5	150.8	107.8	196.1	24.3	15.2	23.1	26.1	88.7	284.8
State budget	104.0	67.2	171.2	113.8	217.8	24.7	15.8	25.6	28.6	94.7	312.5
Of which:											
Valuation adjustment on dollar bonds	...	16.0	...	22.6	...	5.0	4.3	4.3	4.6	18.2	...
Rest of general government	-15.7	-4.7	-20.4	-6.0	-21.7	-0.4	-0.6	-2.5	-2.5	-0.6	-27.7
Other assets net	-92.2	-45.5	-137.7	-62.2	-154.4	-6.2	-10.4	-13.7	-9.1	-39.4	-193.4
Money and quasi money	261.0	100.1	361.1	144.0	405.0	35.8	33.5	40.6	40.1	150.0	555.0
Zloty money	196.5	75.9	272.4	108.3	304.8	29.0	26.0	32.4	29.9	117.3	422.1
Foreign currency deposits	64.5	24.2	88.7	35.7	100.2	6.8	7.5	8.2	10.2	32.7	132.9
(in millions of U.S. dollars)	5,885	452	6,337	706	6,591	10	90	120	180	400	6,991
Memorandum items:											
Nominal money growth during the period (percent change)		38.4		55.2		8.8	7.6	8.6	7.8	37.0	
Inflation during the period (percent change)		34.1		46.7		11.0	6.0	7.0	5.0	32.2	
Net credit to general government excluding valuation adjustment on dollar bonds (trillion zlotys)		46.5		85.2		19.3	10.9	18.8	21.5	70.5	

Sources: Ministry of Finance; National Bank of Poland; and staff estimates.

1/ Stock of Net international reserves at end-1993 reflects adjustment for valuing gold at US$350 per ounce instead of US$400 per ounce beginning January 1, 1993.

Table 4. Poland: Balance of Payments in Convertible Currencies, 1990-93

(In millions of U.S. dollars)

	Year 1990	Year 1991 1/	Jan.-Sep. Prel. Act. 1992 1/	Jan.-Dec. Proj. 1992 1/	Year Program 1993 2/
Exports	10,863	12,760	10,368	14,350	15,475
Imports	-8,649	-12,709	-9,349	-13,685	-14,975
Trade balance	2,214	51	1,019	665	500
Nonfactor services (net)	-150	236	271	355	400
Interest receipts and other factor income	581	541	388	525	590
Interest payment obligations	-3,910	-3,404	-1,685	-2,196	-2,315
Transfers (net)	1,933	353	282	445	306
Current balance	668	-2,223	275	-206	-520
Medium and long term credits	428	786	315	500	950
Loan repayment obligations	-2,954	-6,845	-298	-892	-843
Credit extended etc.	42	13	6	9	11
Direct investment	10	117	185	210	210
Short term capital 3/	124	-2,025	735	326	-765
Overall balance	-1,682	-10,177	1,218	-53	-956
Debt relief	9,054	4,382	--	--	--
Change in arrears	-2,930	4,478	755	1,423	1,156
Increase in net international reserves of banking system (-)	-4,442	1,317	-1,973	-1,370	-200
Gross official reserves (-)	-2,014	866	-96	507	-488
Other net foreign assets (-)	-2,692	116	-1,862	-1,862	-150
Official liabilities (+)	264	335	-15	-15	438
(Of which: to IMF)	500	322	--	--	438

Sources: Data provided by the authorities and staff projection.

1/ Including transactions with the former CMEA area which, from January 1991, are being settled in convertible currencies.
2/ In the absence of a debt and debt service reduction operation with commercial banks.
3/ Including errors and omissions and valuation changes.

Table 5. Poland: Medium-Term Balance of Payments, 1992-2000 1/

(In billions of U.S. dollars)

			Projections						
	1992	1993	1994	1995	1996	1997	1998	1999	2000
Trade balance	0.7	0.5	0.4	0.4	0.4	0.4	0.5	0.5	0.5
Exports	14.4	15.5	16.3	17.4	18.5	19.7	21.1	22.5	24.1
Imports	13.7	15.0	15.9	17.0	18.1	19.3	20.6	22.1	23.6
Nonfactor services (net)	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6
Interest and factor services (net)	-1.7	-1.8	-1.3	-1.6	-1.7	-1.8	-1.8	-1.9	-1.9
Transfers (net)	0.4	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4
Current account balance	-0.2	-0.6	-0.2	-0.4	-0.5	-0.5	-0.5	-0.4	-0.4
Medium and long term capital (net)	-0.4	-1.0	1.2	1.0	0.9	0.4	0.2	-0.1	-0.4
Disbursements	0.5	1.5	1.7	1.7	1.8	1.9	1.8	1.9	1.9
Amortization due 2/	0.9	2.5	0.5	0.7	0.9	1.5	1.7	2.0	2.3
Direct investment	0.2	0.2	0.5	1.0	1.1	0.5	0.5	0.5	0.5
Short term capital	0.3	-0.8	-0.2	--	--	--	--	--	--
Capital account	0.2	-1.6	1.5	2.0	2.0	0.9	0.7	0.4	0.1
Overall balance	-0.1	-2.1	1.3	1.6	1.5	0.4	0.2	0.0	-0.3
Net international reserves of the banking system (-, increase)	-1.4	1.1	-1.3	-1.6	-1.5	-0.4	-0.2	-0.0	0.3
Debt relief	--	7.4	--	--	--	--	--	--	--
Principal	--	6.6	--	--	--	--	--	--	--
Interest	--	0.8	--	--	--	--	--	--	--
Change in arrears	1.4	-6.4	--	--	--	--	--	--	--
Memorandum items:									
Official gross external reserves (in months of imports of goods and services)	3.2	2.3	2.9	3.6	4.3	4.0	3.7	3.5	3.1
Debt service due (percent of exports of goods and services)	19	19	15	16	16	19	18	17	18
Debt (percent of exports of goods and services)	309	276	241	230	221	207	193	181	167

Sources: Data provided by the Polish authorities; and staff estimates.

1/ Assumes completion of a debt and debt service reduction operation with commercial bank creditors in 1993, as well as the completion of the second tranche of the Paris Club debt reduction in 1994.

2/ Including projected cost of debt buyback and debt enhancement in 1993.

Table 6. Poland: Projected Payments to the Fund, 1993-2000

(In millions of SDRs)

	1993	1994	1995	1996	1997	1998	1999	2000	Later	Total
Obligations from existing and prospective drawings 1/	144.9	279.2	212.9	142.3	267.5	207.6	23.8	13.8	6.5	1,298.5
Repurchases	98.9	219.4	167.5	107.0	241.8	197.2	21.7	12.8	6.3	1,072.6
Charges and interest	46.0	59.8	45.4	35.3	25.7	10.4	2.1	1.0	0.2	225.9
Total obligations in percent of quota 2/	15	28	22	14	27	21	2	1	1	131
					(In percent) 3/					
Memorandum items:										
Ratio of obligations to Fund to:										
Exports of goods and nonfactor services	1.2	2.1	1.5	1.0	1.7	1.2	0.1	0.1		
Total debt service due	6.2	13.9	9.4	5.9	8.8	6.7	0.8	0.4		
Gross official reserves	6.6	9.0	5.2	2.8	5.2	4.1	0.5	0.3		
Ratio of obligations to international financial institutions to exports of goods and nonfactor services	2.4	3.2	3.5	3.7	4.8	4.9	4.3	4.6		
Ratio of Fund credit outstanding to:										
Exports of goods and nonfactor services	7.5	5.7	4.2	3.2	1.5	0.2	0.1	--		
Total debt	2.7	2.4	1.8	1.5	0.7	0.1	0.1	--		
Quota 2/	91.3	76.3	59.4	48.5	24.1	4.1	1.9	0.6		

Source: IMF staff.

1/ Assuming all drawings under the proposed SBA are made as set out in Table 7.
2/ In percent of quota under the ninth general review of quotas.
3/ Assuming Poland's external debt and debt service obligations are reduced as implied in table 5.

Table 7. Poland: Purchases Under
Proposed Stand-By Arrangement

Availability	Amount In Millions of SDRs	Conditions 1/
January 1993	71.4 2/	Approval of stand-by arrangement
May 1993	71.4 2/	Observance of March 1993 performance criteria
August 1993	71.4 2/	First review and observance of June 1993 performance criteria
November 1993	190.4 3/	Observance of September 1993 performance criteria
February 1994	71.4 2/	Second review and observance of December 1993 performance criteria

1/ Until an agreement with commercial bank creditors is finalized, progress in reaching a satisfactory agreement with these creditors will also be reviewed prior to each purchase.

2/ Assumes 25 percent of purchase is set aside to be used in support of a debt reduction operation with commercial banks.

3/ Assumes disbursement of accumulated set asides and accelerated disbursement of remaining set aside.

Poland: Fund Relations
(As of November 30, 1992)

I. Membership Status: Joined 6/12/86; Article XIV

II. General Resources Account:

	SDR Million	Percent Quota
Quota	988.50	100.0
Fund holdings of currency	1,507.98	152.6

III. SDR Department

	SDR Million	Percent Allocation
Holdings	0.77	N/A

IV. Outstanding Purchases and Loans:

	SDR Million	Percent Quota
Stand-by arrangements	357.50	36.2
Extended arrangements	76.50	7.7
CCFF	162.60	16.4

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Extended	4/18/91	4/17/94	1,224.00	76.50
Stand-by	2/5/90	3/4/91	545.00	357.50

VI. Projected Obligations to Fund: (SDR Million; Based on Existing Use of Resources Only):

	Overdue	Forthcoming				
	10/31/92	1992	1993	1994	1995	1996
Principal	--		98.9	219.4	167.5	53.4
Charges/interest	--	10.5	36.9	27.6	12.9	4.9
Total	--	10.5	135.8	247.0	180.4	58.3

VII. Exchange Rate Arrangement

The zloty is pegged to a currency composite made up of the U.S. dollar, deutsche mark, pound sterling, French franc, and the Swiss franc. The value of the zloty is depreciated by Zl 12 per business day against this basket. Individuals may make payments and transfers which are not eligible for foreign exchange at the official rate with foreign exchange acquired in the parallel market in which the exchange rate of the zloty is determined freely by supply and demand. On November 30, 1992 the average official rate was Zl 15,454 per US$1.

VIII. Article IV Consultation

The last Article IV consultation was concluded at EBM/92/99 (7/31/92). Poland is on a 12-month consultation cycle. The following decision was taken by the Executive Board on July 31, 1992:

1. The Fund takes this decision relating to Poland's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1992 Article XIV consultation with Poland, in light of the 1992 Article IV consultation with Poland conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Poland maintains exchange restrictions under Article XIV as described in SM/92/139 (7/9/92), and the multiple currency practice that arises from the operation of the parallel exchange market is subject to approval under Article VIII, Sections 2(a) and (3). The Fund encourages Poland to eliminate, as soon as circumstances permit, the exchange restrictions maintained under Article XIV, including those arising under the remaining bilateral payments arrangements. The Fund grants approval of the multiple currency practice that arises from the operation of the parallel exchange market until March 31, 1993.

IX. Technical Assistance, 1991-92

Department	Subject/Identified Need	Action	Timing	Counterpart
MAE	Review of progress made in 1990 and discussion of the desirable pace of further reforms and technical assistance	Mission	January/ February 1991	NBP
MAE	Operational framework for monetary programming and reserve forecasting	Mission	April 1991	NBP
MAE	Banking supervision, central bank accounting, and monetary operations	Mission	April/May 1991	NBP
MAE	Monetary and balance of payments research, legislation, banking supervision, and foreign exchange operations	Mission	June/July 1991	NBP
MAE	Status of NBP-Wire procurement and other payment system and related initiatives	Experts' visit	May/June 1991	NBP

MAE	Task-oriented seminar on domestic public debt management issues and techniques	Mission	December 1991	NBP/MoF
MAE	Current issues in the modernization of the NBP and technical assistance priorities for 1992	Mission	December 1991	NBP
MAE	Payments system, banking supervision, monetary research and analysis	Mission	May 1992	NBP
MAE-coordinated	Periodic visits by experts from central banks cooperating in providing technical assistance to the NBP under the coordination of MAE	Experts' visits	1990-92	NBP
MAE	Review of progress in the modernization of operational functions	Mission	Oct. 1992	NBP
MAE	Resident expert--Advisor to President of NBP		Nov. 91-92	NBP
FAD	Tax administration	Mission	February 1991	MoF
FAD	Budget planning and monitoring and control of budget execution system	Mission	June 1991	MoF
FAD	Tax administration	Short-term assignment of field expert	August 1992	MoF
FAD	Tax administration	Mission	November 1992	MoF

X. Resident Representative

Mr. Mark Allen has been the Senior Resident Representative in Warsaw since March 1990.

World Bank Activity in Poland

1. World Bank Lending

The World Bank initiated lending to Poland in FY90. As of December 30, 1992, loans totalling US$2.6 billion equivalent had been approved, the most recent being the First Housing Loan approved on June 25, 1992. This total includes US$600 million in quick disbursing funds, consisting of US$300 million for a Structural Adjustment Loan, now fully disbursed, and of resources available through the Privatization and Restructuring Project, the Financial Institutions Development Loan, and the Heat Supply Restructuring Loan, all of which are hybrid operations.

World Bank assistance has focussed on support for implementation of the Government's reform program: successful implementation of the Polish multi-track privatization efforts, development of a modern and efficient financial sector, resolution of the financial problems affecting a large number of SOEs, and implementation of an effective social safety net. The World Bank has taken an active role in supporting (through economic work, technical assistance and a small grant) an ambitious program of public administration reform and decentralization. In addition, the World Bank has supported reforms and investments in the agriculture, energy, environment, and infrastructure sectors.

A number of projects are at different stages of preparation for possible approval in FY92 and FY93. An Agriculture Sector Adjustment Loan is expected to be presented shortly for consideration of the Board of Directors. Negotiations will soon take place on an Enterprise and Financial Sector Adjustment loan, a Co-generation Privatization project, a Forestry Development project, and a Roads project. Also under consideration is a DDSR operation pending the successful completion of a London Club Agreement, as well as a quick-disbursing operation to support a strong program of public sector adjustment.

2. Economic and Sector Work

Recent reports include:

- Economic Transformation at a Crossroads, Report No. 10305-POL, May 1992
- Strategic Investment Review, Report No. 10321-POL, March 1992
- Decentralization and Reform of the State, Report No. 10446-POL, April 1992
- Income Support and the Social Safety Net: Policies for the Transition, Report No. 9661-POL, September 1991
- Review of the Private Small and Medium Scale Enterprise Sector, Report No. 8991-POL, June 1991
- Environmental Strategy, Report No. 9808-POL, April 1992
- Health System Reform: Meeting the Challenge, Report No. 9182-POL, January 1992
- Social Sectors Expenditure Review, Report No. 10158-POL, January 1992
- Warsaw Urban Transport Review, Report No. 10624-POL, June 1992
- Telecommunications Sector Survey, Report No. 10166-POL, June 1992

POLAND

STATUS OF BANK GROUP OPERATIONS

A. STATEMENT OF BANK LOANS
(As of November 30, 1992)

Borrower	Project	US$ Million (Less Cancellations) Loan	Undisbursed
One Loan (SAL) Fully Disbursed:			
Repubic of Poland	Structural Adjustment Loan	300.0	
Total Fully Disbursed SAL, SECAL and Program Loans		300.0	
Loans Under Disbursement:			
1990			
National Bank of Poland	Industry Export Devt.	260.0	220.17
National Bank of Poland	Agroindustry Export Devt.	100.0	45.54
Republic of Poland	Environment Management	18.0	11.22
Republic of Poland	Transport	4.8	3.19
Polish State Railways	Transport	145.0	113.56
Polish Oil and Gas Co.	Energy Resources Devt.	250.0	173.59
1991			
Polish PTT	Telecommunications	120.0	100.38
Republic of Poland	Employment Promotion Services	100.0	94.87
Republic of Poland	Financial Institutions Devt.	200.0	124.86
Republic of Poland	Privatization and Restruct.	280.0	262.88
Republic of Poland	Agricultural Devt.	100.0	100.00
Republic of Poland	Heat Supply Restructuring a/	340.0	328.51
Republic of Poland	Health	130.0	130.00
Polish Development Bank	Private Enterprise Devt.	60.0	60.00
Republic of Poland	Housing	200.0	200.00
Total		2,607.8	
Of which: Repaid		-	
Total now held by the Bank		2,607.8	
Total Amount Sold		0.0	
Of which Repaid:		0.0	
Total undisbursed			1,968.77

a/ DHE - District Heating Enterprise. Seven loans made for one project. Loan documents for six of the loans have been signed and are effective.

B. STATEMENT OF IFC INVESTMENTS

(As of September 30, 1992)

Fiscal Year	Obligor	Type of Business	Gross Commitments -------US$ Million------- Loan	Equity	Total
1989	Hortex	Agriculture & Livestock	17.47	-	17.47
1990	EDB-Al a/	Sales & Export Finance Leasing	29.82	-	29.82
1990	EDB-Decmet	Sales & Export Finance Leasing	0.12	-	0.12
1990	EDB-Eurocamion	Sales & Export Finance Leasing	0.06	-	0.06
1990	EDB-Grasi	Sales & Export Finance Leasing	0.10	-	0.10
1990	EDB-Ital-Pol	Sales & Export Finance Leasing	0.30	-	0.30
1990	EDB-Machelewski	Sales & Export Finance Leasing	0.38	-	0.38
1990	EDB-Malkiewicz	Sales & Export Finance Leasing	0.06	-	0.06
1990	EDB-Manczak	Sales & Export Finance Leasing	0.14	-	0.14
1990	EDB-MJA	Sales & Export Finance Leasing	0.48	-	0.48
1990	EDB-Piotr Ostrow	Sales & Export Finance Leasing	0.19	-	0.19
1990	EDB-Rotter	Sales & Export Finance Leasing	0.09	-	0.09
1990	EDB-Rybka Iron Work	Sales & Export Finance Leasing	0.39	-	0.39
1990	EDB-Saar Papier	Sales & Export Finance Leasing	0.21	-	0.21
1990	EDB-Sawena	Sales & Export Finance Leasing	0.82	-	0.82
1990	EDB-Tworczosc	Sales & Export Finance Leasing	0.61	-	0.61
1991	Bristol Hotel	Hotel Development	11.64	-	11.64
1991	International Bank of Poland	Commercial Banks	-	3.20	3.20
1992	Chemagev	Real Estate & Business Service	10.58	1.06	11.64
1992	Philips Poland	Electrical Apparatus	15.00	-	15.00
		Total Gross Commitments	88.48	4.26	92.73
		Less: Cancellations, Terminations, Exchange Adjustments, Repayments, Write-offs and Sales	6.01	0.00	6.01
		Total Commitments Held by IFC	82.46	4.26	86.72
		Total Undisbursed	49.98	1.60	51.58
		Total Outstanding	32.48	2.66	35.14

a/ EDB - Export Development Bank.

Poland: Selected Economic Indicators, 1988-93

(Percentage change unless otherwise indicated)

	1988	1989	1990	1991	Projection 1992	Program 1993
Domestic indicators						
(In real terms)						
Gross domestic product (SNA basis)	4.1	0.2	-11.6	-7.2	-1.0	2.0
Consumption (SNA basis)	2.6	6.1	-11.7	3.3	-0.9	0.8
Gross fixed investment	6.1	-2.1	-10.6	-4.5	--	8.1
Consumer prices (period average)	60.2	251.1	585.8	70.3	45.6	39.0
Consumer prices (12-month increase)	72.9	639.7	249.3	60.4	46.7	32.2
Average monthly wages (period average; nominal) 1/	81.9	291.8	380.0	80.7	35.5	...
Fiscal indicators (in percent of GDP)						
State budget revenues	35.5	30.8	33.3	25.8	26.5	26.7
State budget expenditures 2/	37.0	36.9	32.7	31.7	34.3	31.7
State budget balance 2/	-1.4	-6.1	0.5	-5.9	-7.8	-5.0
General government balance 2/	--	-7.4	3.1	-5.6	-7.2	-4.7
Monetary indicators (end of period)						
Domestic credit (net of general government deposits) 3/	34.4	103.8	82.2	60.2	49.4 4/	32.3 4/
Money and quasi-money	133.0	236.0	121.9	47.4	55.2	37.0
External indicators in convertible currencies (in terms of U.S. dollars)						
Exports 5/ 6/	17.6	4.5	43.4	17.5	12.4	7.8
Imports 5/ 6/	23.1	16.3	17.9	46.9	7.7	9.4
Trade balance						
In billions of U.S. dollars	0.9	0.2	2.2	0.1	0.7	0.5
In percent of GDP 7/	1.4	0.3	3.6	0.1	0.8	0.5
Current account						
In billions of U.S. dollars	-0.6	-1.8	0.7	-2.2	-0.2	-0.5
In percent of GDP 7/	-0.8	-2.6	1.1	-2.5	-0.2	-0.6
External debt (end of period) 8/						
In billions of U.S. dollars	39.1	40.8	49.0	48.4	48.6	49.8
Ratio to exports of goods and nonfactor services in convertible currencies	4.9	4.9	4.0	3.4	3.0	2.7
External debt service ratio 9/						
Due	85	62	56	71	19	19
Paid	20	19	6	9	9	...
Commercial exchange rate depreciation (-) against U.S. dollar (period average)	-38.4	-70.2	-84.8	-10.2	...	...

Sources: Central Statistical Office, Rocznik Statystyczny; data provided by the authorities; and staff estimates.

1/ In the five main areas of the socialized sector through 1990; thereafter in the six main areas of the economy.
2/ On a commitment basis, except external interest which is on a cash basis.
3/ In relation to broad money at end of the previous year.
4/ Excludes increase in net credit to government due to valuation adjustment on domestic debt indexed to the dollar and excludes increase in credit due to capitalized interest.
5/ Balance of payments basis.
6/ Including transactions with former CMEA area for 1991 and 1992.
7/ Gross domestic product in zloty terms is converted into U.S. dollars at the commercial exchange rate.
8/ Including arrears.
9/ In percent of exports of goods and nonfactor services in convertible currencies.

Poland - Stand-by Arrangement

Attached hereto is a Letter, with annexed Memorandum of the Government of Poland on Economic Policies, dated December 14, 1992 from the Minister of Finance of Poland and the President of the National Bank of Poland requesting a stand-by arrangement and setting forth: (i) the objectives and policies that the authorities of Poland intend to pursue for the period of this stand-by arrangement; and (ii) understandings of Poland with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Poland will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement, in accordance with the following provisions:

1. For a period of 14 months from January __, 1993, Poland will have the right to make purchases from the Fund in an amount equivalent to SDR 476 million subject to paragraphs 2,3,4,5 and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 95.2 million until May 15, 1993, the equivalent of SDR 190.4 million until August 15, 1993, the equivalent of SDR 285.6 million until November 15, 1993, and the equivalent of SDR 380.8 million until February 15, 1994.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Poland's currency in the credit tranches beyond 25 percent of quota.

(c) Each of the amounts that would be available in accordance with paragraph (a) above shall be reduced by an amount equivalent to 25 percent. The amount equivalent to corresponding reductions in the purchases made by Poland under this stand-by arrangement shall be made available subject to the following conditions:

(i) Poland represents that it has a need to make a purchase because of the use of its reserves or impending payments for the discharge of liabilities under debt reduction transactions;

(ii) the Fund, after examination of the request, has determined that the requested purchase is needed for the replenishment of Poland's reserves or for the making of payments in connection with Poland's debt reduction operation; and

(iii) the Fund, upon a review of the financing of Poland's program supported under this stand-by arrangement has determined that the debt reduction involved is consistent with the objectives of the program.

(d) Pursuant to a review under (c)(iii) above and, if requested by Poland, the Fund may decide to make available to Poland, notwithstanding the phasing specified under (a) above, an amount equivalent to 25 percent of the total of purchases that may be made by Poland during the remaining period of this stand-by arrangement. In the event, the right of Poland to make purchases under this stand-by arrangement shall be subject to such phasing of purchases and designation of amounts for debt reduction, as shall be determined.

(e) If requested by Poland, the Fund may decide to discontinue the designation of amounts for debt reduction under (c) and (d) above, if the Fund determines that the objectives of Poland's program supported under this stand-by arrangement can be achieved.

3. Purchases under this stand-by arrangement shall be made from ordinary resources only.

4. Poland will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Poland's currency in the credit tranches beyond 25 percent of quota:

(a) during any period of the stand-by arrangement while the limit on the accumulation by the Government of external payments arrears referred to in paragraph 32 of the Memorandum is not observed; or

(b) during any period of the stand-by arrangement in which the data at the end of the preceding period indicate that

(i) the limits on the cumulative deficit of the general government referred to in Appendix A of the Memorandum, or

(ii) the limits on net domestic assets of the banking system referred to in Appendix B of the Memorandum, or

(iii) the limits on net credit of the banking system to the general government referred to in Appendix C of the Memorandum, or

(iv) the targets for net international reserves referred to in Appendix D of the Memorandum, or

(v) the limits on the contracting or guaranteeing of new external debt with an original maturity of more than one year and up to twelve years referred to in Appendix E of the Memorandum,

are not observed; or

(c) after August 14, 1993 until the review referred to in the last paragraph of the Letter has been completed and appropriate understandings have been reached on suitable performance criteria for the remainder of the stand-by arrangement, or after such performance criteria have been established, while they are not being observed; or

(d) after February 14, 1994 until the review referred to the last paragraph of the Letter has been completed; or

(e) after May 14, 1993, August 14, 1993, November 14, 1993, and February 14, 1994 until the respective financing reviews contemplated in last paragraph of the Letter have been completed, provided that no such reviews shall be necessary after the Fund determines that satisfactory arrangements with commercial banks for the financing of the program have been reached; or

(f) during the entire period of this stand-by arrangement, if Poland

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Poland is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Poland and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Poland will not make purchases under this stand-by arrangement during any period of the arrangement in which Poland has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase or pursuant to Decision No. 9331-(89/167), as amended.

6. Poland's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Poland. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Poland

and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Poland, the Fund agrees to provide them at the time of the purchase.

8. Poland shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Poland shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Poland's balance of payments and reserve position improves.

(b) Any reduction in Poland's currency held by the Fund shall reduce the amount subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

10. During the period of the stand-by arrangement, Poland shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Poland or of representatives of Poland to the Fund. Poland shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Poland in achieving the objectives and policies set forth in the attached Letter and annexed Memorandum.

11. In accordance with the last paragraph of the attached Letter, Poland will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed, or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Poland has outstanding repurchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Poland's balance of payments policies.