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August 18, 1987

To: Members of the Executive Board

From: The Acting Secretary

Subject: Poland - Staff Report for the 1987 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with Poland, which will be brought to the agenda for discussion on Wednesday, September 16, 1987. A draft decision appears on page 20.

Mr. Prust (ext. 7884), Ms. Swiderski (ext. 8804), or Mr. Boote (ext. 8801) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

POLAND

Staff Report for the 1987 Article IV Consultation

Prepared by the Staff Representatives for the Consultation

Approved by Massimo Russo and J.T. Boorman

August 17 , 1987

I. Introduction

A staff team visited Warsaw in the period June 17-July 1 to conduct the 1987 Article IV consultation discussions. The team consisted of Mr. Prust (head, EUR), Mr. Wolf (RES), Ms. Puckahtikom (ETR), Ms. Swiderski (EUR), and, as secretary, Mrs. Harvey (ETR). Mr. Lav (IBRD) also participated. The team met with Professor Sadowski, Deputy Prime Minister with special responsibility for economic reform; Mr. Samojlik, Minister of Finance; Professor Baka, President, National Bank of Poland; deputy ministers in the State Planning Commission, the Ministry of Finance, the Ministry of Foreign Trade, and the Ministry of Labor; and with other officials of these and other government departments.

Poland, an original member, rejoined the Fund and the World Bank in June 1986. The Executive Board discussed the staff reports for the 1986 Article IV consultation in October, 1986. The Polish authorities have stated that they wish to begin discussions on a possible stand-by arrangement from the Fund. Poland avails itself of the transitional provisions of Article XIV, section 2.

No decision has yet been taken regarding possible lending to Poland by the World Bank although considerable work has been done in identifying areas for possible project loans.

In their discussion concluding the 1986 Article IV consultation, Directors viewed the medium term balance of payments plans of the Polish authorities at the time as inadequate; these foresaw no reduction in the external current account in convertible currencies until after 1990. Directors were generally of the view that the convertible current deficit should be rapidly eliminated and that a significant surplus should thereafter be maintained for some years. Directors generally endorsed the staff's suggestions that this goal should be achieved by, inter alia, price reform and exchange rate adjustment, tighter demand management, strengthened financial discipline, and a general liberalization of economic relations.

II. Background to the Discussions

1. Developments up to 1982

A period of very rapid expansion in the early 1970s quickly led to the emergence of an unsustainable current external deficit with the nonruble area. 1/ Measures to redress the situation led to some reduction in the merchandise trade deficit but to no lasting reduction in the current account deficit, partly because of rising interest rates in international markets. External debt and debt service obligations continued to mount and, with the collapse of creditor confidence in 1981, ultimately became unmanageable.

The domestic economic situation also worsened progressively after the mid-1970s. Efforts were made to insulate consumer expenditure from the effects of the deteriorating situation and the brunt of retrenchment measures fell on investment and on imports of intermediate and capital goods. The result was a progressive decline in domestic output after 1978. Domestic disequilibria intensified, to which the authorities responded in 1980 with an attempt to introduce substantial price increases. The latter met with strong opposition from the population. Despite signature of an accord between the Government and the labor movement in 1980, social tensions continued to rise and martial law was imposed on December 2, 1981. 2/ The downward trends in the economy did not bottom out until 1982, when real output amounted to only three quarters of the pre-crisis peak level attained in 1978.

2. Domestic economic developments since 1982

Since 1982 there has been an at least partial recovery in all aspects of economic performance (Table 1). By 1986 real output was less than 10 percent below its pre-crisis level while per capita consumption had almost regained the previous peak level reached in 1980 (Table 3). Fixed investment, however, remains significantly below its pre-crisis level; it was equivalent to 22 percent of GDP in 1986 compared with a ratio of almost one third in the mid-1970s. The recovery was led by the abatement of labor unrest and higher output in the critical coal mining sector. Moreover, there was a series of good agricultural years and rising import volumes permitted a recovery in rates of capacity utilization. These favorable developments were underpinned by the authorities' economic reform initiatives and by policies that greatly reduced the degree of domestic disequilibrium. The latter included restrictive

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1/ Transactions with the nonruble area comprise transactions in convertible currencies and transactions under bilateral clearing arrangements with countries other than members of the CMEA (Council for Mutual Economic Assistance).

2/ Martial law was lifted on July 22, 1983.

financial policies and a price liberalization and restructuring which doubled the price level in 1982. Total output grew by 5.5 percent annually in 1983-84.

In 1985 there was some faltering in the growth rate which was partly weather-related. Despite contrary indications in the early part of the year, strong growth in output was resumed in 1986: real output grew by 5.2 percent compared with a plan target of a little over 3 percent. In part, this resulted from favorable agricultural performance (Table 4). The industrial sector also showed above-plan growth which partly reflected gains in labor productivity and reductions in the material and energy intensity of output.

In the early years of the recovery phase, 1983-84, domestic expenditure growth was held below that in output. In 1985 and 1986, however, financial and incomes policies eased. Broad money grew somewhat more rapidly than nominal incomes--by 25 percent in 1986 (Table 11)--largely because of rapid credit expansion to the enterprise sector. The state budget continued to record a moderate deficit, with revenues and expenditures rising at about the same rate as nominal GDP, while the position of the general government (including extrabudgetary funds) remained broadly in balance. Inflationary pressures have intensified and the increase in prices--about 18 percent in 1986--has exceeded official targets. The authorities' hopes for restraining wages by taxing excessive increases were not met because of the granting of numerous exemptions from this tax; real wages grew by a total of 5.5 percent in 1985-86.

3. External economic developments with the nonruble area since 1982 1/

a. Balance of payments

The current external deficit in convertible currencies was reduced from a peak of US$3.2 billion in 1981 to about US$0.6 billion in 1985 and 1986 (Table 5). Through 1984, the improvement was due to a combination of a rising trade surplus, declining international interest rates, and strong growth in receipts from private transfers. Subsequently, the trade surplus has fallen--to about US$1 billion in 1986--and interest payment obligations have remained stable at about US$2.7 billion. The further modest reduction in the current deficit has resulted from the continuing growth in private transfer receipts.

1/ Balance of payments data are prepared separately for the convertible and nonconvertible currency areas. Trade data, which are on a customs basis, are prepared separately for nonruble transactions (including transactions under clearing arrangements with non-CMEA countries) and ruble transactions.

After declining in 1985, export volumes rose slightly in 1986 (Table 6). In the latter year, exports of manufactures increased for the first time in many years--by some 21 percent in terms of U.S. dollar values--most of which resulted from sales in West European markets. Despite the Chernobyl accident, exports of agricultural products also continued to expand. However, the performance of nonruble exports in the aggregate was adversely affected by a decline in sales of Poland's largest single export item, coal, which partly reflected a diversion of supplies to CMEA markets. The growth in import volumes slowed appreciably in 1986--to 3 percent--and was concentrated in investment goods; the volume of imports of intermediate goods, which account for about two thirds of nonruble imports, fell slightly. An important feature of trade developments with the nonruble area in 1986 was the very rapid increase in turnover under bilateral clearing agreements with developing countries; these transactions, together with those under barter arrangements, currently account for over 20 percent of nonruble trade.

Capital account developments in recent years have been characterized by only minimal inflows of new medium- and long-term credits and by heavy principal repayment obligations. In 1986, principal repayment obligations (before debt relief) totaled US$3.5 billion of which US$1.2 billion was due to Paris Club creditors and US$1.6 billion to commercial banks. The financing requirement arising from the persistence of a current account deficit and the high level of principal repayment obligations has been met mainly by recourse to debt rescheduling and the incurrence of arrears. At end-1986, external arrears totaled US$3.4 billion, almost all of which was owed to Paris Club creditors.

b. <u>External debt, debt service, and debt rescheduling</u>

At end-1986 Poland's total external debt in convertible currencies was equivalent to US$33.5 billion, of which US$1.4 billion represented short term claims other than arrears (Tables 7 and 8). Western official creditors participating in the Paris Club held 64 percent of the medium- and long-term debt, as compared with 25 percent held by commercial banks, and 7 percent by CMEA countries and institutions. The debt service ratio (on an accrued obligations basis) was 105 percent in 1986; on an actual payments basis it was only 32 percent.

About 85 percent of the total debt has already been rescheduled. Since 1981 a series of agreements has been concluded with commercial banks covering maturities due through 1987. Typically, these agreements have provided for repayment of a small proportion of the relevant principal amounts and for payment of interest; under certain agreements, however, some interest payments have been recycled through the provision of revolving trade credits. Discussions with commercial banks are at an advanced stage on the rescheduling of maturities in 1988 and beyond.

With Paris Club creditors, there was a hiatus in discussions following conclusion of a first agreement in 1981. Agreements were signed in 1985 which rescheduled all payments of principal, interest, and late interest due in 1982-85, except those related to the 1981 agreement. Discussions have been continuing since early 1986 on rescheduling post-1985 maturities but have not yet been concluded. In 1986 debt service payments to Paris Club creditors amounted to only about US$500 million (or 26 percent of total debt service payments actually made), and arrears mounted--to US$3.3 billion by end-year.

4. External developments with the ruble area 1/

Roughly one half of Poland's trade is conducted with the ruble area, the large majority of which is with the Soviet Union. The current and trade accounts with the ruble area have been in deficit since the second half of the 1970s (Table 9). 2/ Poland's debt in transferable rubles at end-1986 stood at TR 8.7 billion (equivalent to US$4.2 billion) and was the largest TR-denominated debt of any CMEA country. Poland has been under pressure from its CMEA creditors to eliminate its current deficit and, from 1988, to begin to repay its debt. The volume of trade turnover with the ruble area, especially with respect to Polish exports, has been growing relatively fast in recent years, and considerably faster than that with the nonruble area. In 1986, export volumes grew by about 9 percent while import volumes increased by about 6 percent. The trade deficit fell from TR 1.2 billion in 1985 to TR 0.9 billion in 1986; in terms of U.S. dollar equivalents, the deficit was almost halved to some US$0.5 billion in 1986.

5. Prospects for 1987

The growth rate of net material product (NMP) is forecast to slacken appreciably, to 2.4 percent in real terms, largely because of the expectation that gross agricultural output will remain unchanged (Table 4). Favorable weather at harvest time could, however, permit a somewhat better result. Gross industrial production is also expected to increase more slowly than in 1986, in part because of the disruptive

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1/ Transactions with the ruble area are denominated in transferable rubles (TRs) and are converted into U.S. dollar equivalents at the cross rate implicit in the Polish official quotations (in terms of zlotys) for the two currencies. Because of the more rapid depreciation of the zloty against the U.S. dollar than against the TR, this cross rate has changed appreciably in recent years with the result that the U.S. dollar equivalent of transactions with the ruble area has risen less (or fallen more) than have the corresponding values in terms of TRs.

2/ In addition to transactions denominated in TRs with CMEA members, the data in Table 9 include transactions under bilateral payments arrangements with non-CMEA members. In 1986 merchandise trade under the latter arrangements accounted for 14 percent of total merchandise trade turnover in nonconvertible currencies.

effects of an exceptionally severe winter. Real domestic spending is forecast to rise at about the same rate as aggregate output. However, with unchanged stockbuilding, the volumes of final consumption and investment expenditure are expected to rise more rapidly than output, by 2.5 percent and 3.3 percent, respectively. The authorities hope to prevent more than a small rise in the rate of inflation, from about 18 percent to about 20 percent, and to limit the rise in nominal wages so as to achieve a small decline in real wages. There is some doubt as to whether these latter targets can be achieved, however, as in the first five months at annual rates the average wage in major sectors increased by over 20 percent and total money receipts of the population grew by 26 percent.

Regarding financial developments, the authorities hope to reduce monetary expansion to a rate below that of the increase in nominal incomes. It is planned to eliminate the deficit on the state budget (Table 10). However, expenditures are running ahead of target, largely because the scale and timing of administrative price measures introduced in March is likely to be insufficient to allow the budgeted cut in subsidies to be achieved. The authorities, nonetheless, hope to achieve the intended balanced budgetary position, largely through a package of expenditure-reducing measures introduced in April. Of greater quantitative significance for the rate of monetary expansion, the authorities plan to reduce the rate of credit expansion to enterprises (to 17 percent from 19 percent in 1986). However, in the first four months these credits were increasing faster than planned, as was broad money.

Developments in the external position are expected to differ significantly between the convertible and nonconvertible areas, as they did in 1986. With the nonconvertible area, the trade and current deficits are expected to be greatly reduced, if not eliminated altogether, partly on account of a terms of trade improvement associated with a further decline in the price of oil imports. With the convertible area, the current account deficit is officially expected to deteriorate by some US$100 million to US$800 million, because of a rise in interest payment obligations and a decline in private transfer receipts. The trade surplus is forecast to remain virtually unchanged at about US$1 billion, with the effects of more rapid growth in the volume of imports (4 percent) than exports (2 percent) being offset by a further terms of trade gain. If trends in the first half, as recorded on a customs basis, were to continue, the trade surplus could exceed current official forecasts. Similarly, in the staff's view, the official forecast of a fall in receipts from private transfers could also prove unduly conservative. The authorities expect only small inflows of medium- and long-term capital. If the official forecasts for trade, private transfers, new capital inflows, and miscellaneous items were to be met, the total funds available for debt servicing would be on the order of US$1.8 billion.

Against this, currently accruing debt service obligations in 1987 (i.e., excluding arrears at end-1986) are forecast at US$5.1 billion, of which about US$3.1 billion is owed to Paris Club creditors.

III. Basic Policy Objectives

1. Economic reform

Reform of the economic system has--albeit intermittently--been an important policy objective in Poland for much of the postwar period. Pressures for reform were strengthened as a result of the economic crisis of the early 1980s. Legislation was passed in 1981-82 providing the framework for a comprehensive economic reform with the basic objective of decentralizing economic structures. The role of the central administration and of the central plan was to be reduced while enterprises--with the exception, at least initially, of those in certain key sectors--were to be given greater autonomy and subjected to greater financial discipline, including the possibility of being declared bankrupt. The intended abandonment of interventionist central planning necessarily involved not only a greater role for aggregate financial policies but also, if financial magnitudes were accurately to reflect relative costs and prices, a reform of the price structure. This in turn implied the need to reduce subsidies, move toward a more standardized tax system, realign the exchange rate, and relate domestic and world prices more directly. Despite the implementation of measures in these areas, the operation of the economy continued to differ in many important respects from that envisaged in the original reform blueprint. Prices continued to embody serious distortions and were subject to extensive controls, and financial discipline remained weak. Exchange rate adjustments lagged domestic price changes, thereby perpetuating a general underpricing of tradeable commodities. More generally, the central authorities, including the branch economic ministries, continued to play an active role in guiding the operations of enterprises, and the allocation of many commodities--both production inputs and finished goods--as well as foreign trade remained heavily subject to administrative control.

The implementation of the reform progressively lost momentum after 1982 and in some respects, notably in an increase in the scope of price controls, early progress toward the reform's objectives was eroded. The quinquennial congress of the Polish United Workers' Party, meeting in mid-1986, urged that efforts be made to reinvigorate the reform process. A draft set of proposals was issued in the spring of this year. These call for some further institutional and legislative changes, notably a reduction in the number and role of branch economic ministries and a decentralization of the banking system, as well as for changes in economic policy. However, the ongoing policy debate has so far emphasized general principles, and firm decisions on the scale and timing of measures, and the modalities for their introduction, have yet to be taken. This is true in a number of areas including credit policy, which is to be more restrictive; interest rates, which are to be made positive in real terms; price policy where several variants for price adjustments over the 1988-90 period are being considered; wage policy, where the general objective is to tie incomes more closely to productivity; and the taxation system, which is to be made more uniform.

2. External objectives and the medium term outlook

During the recent mission, the authorities presented a revised medium-term scenario for the balance of payments with the convertible currency area (Table 12). This envisages that a rising trade surplus will permit a progressive reduction in the current deficit after 1988 and its elimination in 1991. The volumes of exports and imports are to grow at average annual rates of 6.3 percent and 3.7 percent, respectively, in 1988-91. The envisaged increases in net exports to the ruble and nonruble areas in constant prices are each equivalent to about 1 1/4 percent of estimated 1987 GDP. The increase envisaged in total net exports through 1991 is broadly consistent with official forecasts of growth in real GDP and final domestic expenditure at average annual rates of about 3 percent and 2.5 percent, respectively, over a similar period.

In presenting their latest scenario, the Polish representatives stated that more rapid external adjustment is not possible without potentially harmful restraint on the growth of domestic expenditure. They believe that the projected rate of growth of real consumption--almost 2 1/2 percent annually--is, for social reasons, the minimum that could be accepted and that the necessary restructuring of the economy and improvements in labor productivity will be easier to achieve in a context of generally rising household incomes. The authorities also believe that there is no scope for lowering the growth of real fixed investment below that now foreseen (3 percent) given the need for replacement and modernizing investment; the capital stock is relatively old, with 40 percent of machinery and equipment having been installed before 1976. The authorities also note that the process of restructuring will itself in many instances require additional investment outlays as will the development of new energy sources that is necessitated by the prospective leveling off in coal production. Finally, the authorities stressed that, in view of the continuing reliance of the economy on imports from the nonruble area, the limitation, and possibly reduction, of import volumes which faster external adjustment might entail would have strong adverse effects on output growth.

The mission argued that more rapid adjustment was called for by the needs of the external financing position which was characterized by heavy reliance in debt rescheduling and large and growing arrears on debt service payments. If measures were introduced promptly to sustain the rate of output growth at about its recent level, such an adjustment should also be feasible without undue sacrifice of domestic objectives, given that the present external current deficit in convertible currencies was equivalent to only some 1 percent of GDP. 1/ There appeared to be three main--and not mutually exclusive--channels through which more rapid adjustment could be made possible: lower growth in domestic expenditure, ideally accompanied by increases in its efficiency, particularly as far as investment was concerned; more rapid growth in output through vigorous implementation of economic reform and accompanying policy measures; and, finally, slower current account adjustment with the ruble area.

The Polish representatives questioned the usefulness of the ratio of the current external deficit to GDP as an indicator of the size of the adjustment task. They argued that, primarily because of technological and quality factors, many goods which were domestically absorbed were very imperfect substitutes for exports to the nonruble area. For these reasons, a given reduction in domestic expenditure from some notional level would lead to a much less-than-equal increase in net exports to the nonruble area. The mission suggested that the influence of such factors should not be overemphasized. First, the possibilities for substitution between domestic absorption and exports should not be considered only at the level of finished goods: the--probably greater--possibilities at the level of primary and intermediate inputs should also be taken into account. Secondly, substitution possibilities are also influenced by the extent to which the general policy environment gives enterprises the incentive and ability to seek overseas markets and to offer competitive prices.

Regarding the possibility of limiting the growth of domestic expenditure, the mission noted that real wages and consumption had grown relatively rapidly in recent years, particularly in 1986. Consumption per capita has virtually returned to the peak pre-crisis level attained in 1980--a level which, given the massive external disequilibrium at the time, was clearly not sustainable. The urgency of the need to allow real consumption to continue to grow at almost 2 1/2 percent annually as the authorities planned was therefore open to question. The mission also suggested that there were substantial opportunities for raising the efficiency of investment such that investment expenditure could be reduced from the levels currently planned without any real loss in production capacity. The mission noted the long gestation period for many projects (about four years on average) and the relatively high proportion of investment devoted to projects started several years ago which may be of doubtful viability in present circumstances. Moreover, the share of fixed investment devoted to buildings (63 percent in 1986) seemed excessive, as did the share of aggregate expenditure devoted to stockbuilding (about 7 percent in 1986). The mission argued that the introduction of positive real interest rates would have a substantial beneficial impact in all these areas. The Polish representatives agreed that there could be such effects and said that it was their intention to

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1/ Some illustrative scenarios prepared by the staff are described in Appendix IV.

introduce positive real interest rates. But they doubted that the impact of this move would be particularly large, at least in the short term.

As regards the potential for higher output growth, the Polish representatives said that their forecasts already assumed increases in labor productivity and in the efficiency with which energy, raw materials, and other production inputs were used. In making these forecasts, the authorities had been cautious in assessing the effects of measures to be introduced as part of the second stage of economic reform because past experience with such measures was limited. In addition, to be effective, many of these measures would require changes in basic attitudes and long-established practices which could only be expected to come about slowly.

As regards the possibility of slowing the rate of repayment of TR-denominated debt, the Polish representatives stressed the pressures which they faced from their CMEA creditors. Moreover, although the quality requirements of CMEA trading partners were rising, many goods--especially manufactures--which were exported to the ruble area could not readily be sold in other markets. The Polish representatives also said that the possibilities for lowering exports and/or raising imports of primary and intermediate products in trade with the ruble area had been exhausted. It was noted that the rapidity of the recent and prospective current account adjustment with the ruble area reflected terms of trade gains as well as volume factors.

IV. Policy Issues

1. Demand management policies

The mission stressed the importance of demand management policies in the achievement of both short-term stabilization goals and longer-term systemic reform. It argued strongly that, in formulating such policies, it is necessary to take a view on the appropriate level of liquidity as well as its rate of change. The prolonged existence of price controls and supply shortages may have led to involuntary accumulation of financial assets by households as well as to the growth of a sizeable "second economy." In addition, there is evidence that, at least in the aggregate, the enterprise sector is in a very liquid position, as evidenced, for example, by excess demand for fixed investment and continued rapid stockbuilding. The mission recognized that quantification of these effects was problematic in the absence of well-defined savings and money demand functions. 1/ Nevertheless, the liquidity which was currently involuntarily held or absorbed in the second economy would need to be reckoned with as a potential source of inflationary pressure if prices in the official sector were allowed to move to market clearing levels. Officials were inclined to emphasize the rate of forced saving (a flow concept) as an indicator of excess demand and, correspondingly, to downplay the dangers that the accumulated stock of such savings might pose to macroeconomic stability. They believe that this stock is concentrated in the hands of a relatively small proportion of the population and also that it reflects excess demand for a relatively narrow range of goods.

The mission emphasized the need for a careful coordination of policies to lower excess demand pressures. In particular, it was important to take a view on the extent to which adjustments in the economy's real liquidity were to be achieved through price increases designed to lower the real value of existing nominal balances, and to what extent they would be achieved through monetary and fiscal policies designed to operate on the nominal money supply. There was, however, a clear need to reduce the rate of credit expansion to enterprises which was the main factor underlying the rapid growth in the money supply. Price controls and instruments such as the tax on excessive wage increases were unlikely to be effective as long as financial policies remained as expansionary as in the recent past. Moreover, it was preferable on efficiency grounds that aggregate financial policies be the primary instrument in controlling nominal incomes and prices.

The mission urged the authorities to introduce a structure of interest rates that was positive in real terms. 2/ This would produce benefits on several fronts. It would increase households' demand for financial assets and therefore reduce inflationary pressures. It would also reduce the demand for socially unproductive investment by enterprises, notably in stocks and buildings, as well as their demand for bank credit. The mission noted, however, that it would be important to allow enterprises to pass on the effects of higher interest costs in their selling prices.

1/ Since households may not have been in equilibrium with respect to liquidity holdings in certain periods, historical data may be of limited use as a guide to households' voluntary behavior. An additional difficulty is that households' liquidity is held not only in zlotys but also in foreign currency-denominated bank deposits and in foreign bank notes. The amount of the latter is not known but may be substantial. Moreover, there is a question as to how all foreign currency-denominated holdings should be valued.

2/ The average interest rate on bank credits is currently 6.3 percent and that on banks deposits is 5.0 percent; this compares to a rate of inflation currently in the range of 18-20 percent.

2. External policies

A dominant feature of recent external policies has been the use of a more active exchange rate policy than previously. Exchange rates for the zloty for nonruble transactions are set on the basis of a weighted basket of currencies. Adjustments against the basket are made periodically to reflect inflation differentials and with a view to securing the profitability 1/ of about 80 percent of exports. In practice the latter target has been consistently undershot although, as a result of the recent devaluations, by a smaller margin in recent months than previously. After appreciating in real effective terms through the fourth quarter of 1983, there has since been a real effective depreciation totaling 55 percent. Of the latter, 26 percentage points reflect changes since August 1986. In September 1986 and February 1987, there were large discrete devaluations--both of almost 20 percent--and since April of this year there has been a series of smaller adjustments.

It was recognized that there was a need to keep the level of the exchange rate under review in light of ongoing trade performance. In this regard, the comparatively buoyant performance in 1986 and early 1987 of price-sensitive exports such as manufactures was noted. However, the Polish representatives were inclined to see this as a response to a general increase in the emphasis placed on exporting by enterprises to which the more active exchange rate policy of the last year had been but one of several contributory factors. The mission argued that the need for further exchange rate changes should also be looked at in the context of a number of other more general considerations concerning the exchange system.

In the first place, the mission questioned the authorities' policy of determining the exchange rate on the so-called "submarginal" basis, i.e., with a view to achieving the profitability of less than 100 percent of exports, and granting subsidies to unprofitable exports. The Polish representatives noted that, in practice, nonprofitable exports were concentrated among agricultural products and the output of certain traditional industries, such as shipbuilding, both of which were subsidized in many countries. The mission argued that the primary consideration in setting the exchange rate should be the achievement of a desired level of net foreign exchange earnings, which bore no necessary relation to the level of profitability of existing exports. The present policy carried a built-in disincentive for the development of new, and marginally profitable, export activities and thus tended to perpetuate a structure of exports that was not necessarily appropriate.

1/ Profitability is defined as being achieved when the ratio of the export price to the domestic price of a given commodity exceeds unity.

The mission also urged that future exchange rate changes be coordinated with a simplification of the current complex and unstable array of supplementary export incentives. In addition to export subsidies, a major item in the latter category is income tax relief for exporters, which, as the authorities recognize, represents a large and growing cost to the budget. The mission argued that a comparable effect on incentives would be provided more effectively through an across-the-board adjustment in the exchange rate.

The mission noted that there was considerable scope for improving the effectiveness of the exchange rate as an instrument in reallocating resources. It suggested that a reduction in price controls and the phasing out of "equalization payments" (i.e., levies and subsidies) on imports and exports would promote a more systematic and rapid pass-through of exchange rate changes to the domestic price structure (see section IV. 3, below). Secondly, the mission noted that the efficacy of the exchange rate is likely to be severely hampered by the continuation of extensive administrative controls on foreign trade. Such controls, to some degree or other, presently affect a substantial proportion of exports to the nonruble area. The mission urged the authorities to progressively dismantle these controls while at the same time liberalizing the import regime.

Changes in procedures affecting foreign exchange retention accounts for exporters were introduced early this year; enterprises were granted legal ownership of retained foreign exchange and an auction system was established under which enterprises may sell retained foreign exchange in excess of their requirements at freely negotiated prices. 1/ The mission argued that the use of retention accounts as an export incentive should be seen as a temporary arrangement and should not detract from the primary function of the exchange rate in this regard. In part, this was because retention accounts may perpetuate an unnecessary dependence on imports, especially where retention quotas are geared to the existing import intensity of production. Thus, while advocating the dismantling of the retention system as an ultimate objective, in the interim the mission urged the authorities to consider the introduction of a standard, across-the-board retention rate. The Polish representatives said that they too favored a standard retention rate but had not yet introduced one because of their desire to minimize the amount of changes in the system that were made at any one time. They indicated that an expansion in the scope of retention accounts would be the principal vehicle for import liberalization over the medium term. The mission noted that this move would need to be accompanied by restraint on the level of centrally financed imports.

1/ The scale of auction sales has so far been small. The exchange rates at which transactions were concluded in the early sales were about Zl 1,000 = US$1. These rates are close to that prevailing in the parallel exchange market and compares with an official rate of Zl 269.4 = US$1 (end-July, 1987).

3. Other pricing issues

The mission welcomed the authorities' intention to progressively reduce the existing distortions in the price structure and to phase out price controls, as well as the steps taken in this direction so far this year: energy prices were raised substantially and there were modest reductions in the incidence of administrative price controls. Three variants of possible price policies in the medium term are under consideration. The first incorporates a large upward adjustment in prices in 1988--notably for energy products--but relatively low rates of inflation thereafter. This variant was thought likely by the Polish representatives to prove unacceptable for social reasons. The second and third variants incorporate, respectively, slower price adjustments. The third variant was thought by the Polish representatives to entail an unacceptably slow approach to domestic financial equilibrium. Attention was therefore tending to focus on the second variant, which would spread out price increases more or less evenly over three years, with an annual inflation rate of 15-20 percent and real wages kept constant; coal prices, would be sharply increased in the first year. However, final decisions had not yet been taken.

The authorities' policy intentions are being framed with a view to securing (i) a restructuring of relative prices which, in particular, would involve a reduction in budgetary subsidies; and (ii) the achievement of domestic financial equilibrium. The Polish representatives noted that these two objectives were not identical. For instance, relative prices could be restructured, and subsidies eliminated, but excess demand pressures could still persist. The mission also noted that there was no necessary relationship between the restructuring of relative prices and changes in the absolute price level. To the extent that relative price changes yielded additional resources to the budget--as they did in cases where a reduction in subsidies was involved--there would be a possibility of using at least some of these additional resources to finance across-the-board reductions in taxes to dampen the rise in the price level. The Polish representatives said that, in practice, the scope for such reductions would be limited and that any net accrual of resources to the budget as a result of price adjustments would, for aggregate demand management purposes, be devoted to a decrease (increase) in the budget deficit (surplus).

4. Financial discipline, factor mobility, and central allocation of resources

The mission stressed that for pricing and exchange rate measures to be effective, it was essential to strengthen financial discipline in the enterprise sector. Without such discipline, changes in costs and prices were more likely to cause enterprises to search for financial relief rather than to improve their commercial performance. A reduction in the discretionary intermediation of resources through the state budget and extrabudgetary funds would be a vital part of an overall tightening of financial discipline. In addition to reducing direct subsidies, this would require a movement toward a more uniform and less discretionary tax system. At present the tax system is characterized by a proliferation of complex special provisions which are subject to frequent change, partly in response to bargaining between enterprises and the Government. The Polish representatives said that they recognized the need to introduce a more standardized tax system and they expected to make significant progress in this area in the next three years. The mission stressed that criteria governing access to bank credit also need to be tightened if financial discipline is to be improved; positive real interest rates would greatly facilitate the achievement of this objective.

The effectiveness of price measures is also dependent on a coordinated reduction in the central administrative allocation of resources--which the price measures themselves are in part intended to facilitate--and on enhanced mobility of capital and labor. Some 35 percent of the value of material inputs continue to be centrally allocated, although by 1990 it is intended that central allocation will only apply to fuels and energy and a limited number of economically strategic commodities. Capital mobility continues to be limited by various institutional barriers, as well as by interest rate policy, and labor mobility is also limited, primarily by an acute housing shortage.

V. Staff Appraisal

The recovery of output and expenditure levels from the crisis of the early 1980s continued--at an accelerated pace--in 1986. Although an unusually good agricultural year contributed substantially to output growth, it was encouraging that in the industrial sector there were gains in labor productivity and in the efficiency with which energy and materials are used. Reflecting the loose stance of financial and incomes policies, virtually all of the increase in output was absorbed by domestic expenditure. For the second consecutive year, there was an increase in the rate of inflation--to about 18 percent--and real wages increased significantly more than planned. Regarding external developments, there was a small increase in the current account deficit with the convertible area with which trade performance was, overall, disappointing. However, the growth in exports of manufactures, after years of decline, was an encouraging sign. Private transfers became increasingly important as a source of current external receipts and were only slightly less than the trade surplus.

For 1987, some slackening in the growth rate is forecast largely because of the expectation of a decline in agricultural value added. Developments in the early part of the year indicate that inflationary pressures have, if anything, continued to intensify. The authorities expect the current account position with the convertible area to deteriorate somewhat as a result of a reduction in private transfer receipts and an increase in interest payment obligations. On the basis of developments so far, however, the staff believes that a reduction in the current deficit could be possible.

The external financial situation with the convertible currency area remains extremely weak. Poland continues to be heavily reliant on exceptional financing and the substantial and mounting volume of payments arrears is a matter of serious concern. The authorities foresee the need for a continuing reliance on debt rescheduling which, ideally, they would prefer to be in the form of long term, i.e., multiyear, arrangements. Concurrently, they foresee a progressive move to current account balance in convertible currencies. The adoption of the target date of 1991 for the achievement of balance, and the progress toward that target foreseen in the intervening years, marks an encouraging change from positions previously taken by the Polish authorities on this matter. (In scenarios presented at the time of the 1986 Article IV consultation, the Polish authorities foresaw no reduction in the current deficit through 1990. Executive Directors found this adjustment path clearly inadequate and urged rapid movement to balance to be followed by a period of significant surpluses.) The question that arises is whether more rapid adjustment than now foreseen by the Polish authorities is desirable and feasible. In the staff's view, the answer is in the affirmative on both points. Achievement of current balance--and, in particular, the prospect that it would hold for a more complete honoring of interest payment obligations--would improve the environment for debt rescheduling negotiations and would pave the way for a progressive reduction in reliance on debt relief. More generally, the demonstrated willingness of the Polish authorities to stabilize--and afterwards reduce--the country's excessive external debt is a necessary step if perceptions of Poland's creditworthiness are to improve and if voluntary capital inflows are to increase from their present low levels.

The staff believes that vigorous and concerted implementation of measures along the lines recommended below would allow current balance to be rapidly achieved without undue sacrifice of domestic objectives. The staff finds the authorities' reservations about the substitutability of domestic absorption and exports unconvincing and believes that the relatively low level of the current deficit in relation to GDP (some 1 percent) is a strong indication that the task is feasible. The current account position with the nonconvertible area is expected to be close to balance in 1987, after nearly a decade of deficits, and thereafter to be in surplus. The trade-off between adjustment with the convertible currency area and domestic objectives would, of course, be eased to the extent that the repayment of debt to the ruble area--which is relatively small in relation to that with the nonruble area--could be slowed compared with the profile now envisaged.

The staff supports the broad objectives of the authorities' plans for what has come to be known as the second stage of economic reform. However, there is an urgent need to distill from the many proposals now under consideration a concrete and coordinated set of measures that focuses on the economy's most pressing problems. In formulating such a package there is a need to introduce measures that are comprehensive in their scope and mutually reinforcing: isolated actions are likely to be, at best, ineffective. In the staff's view a limited number of--admittedly substantial--policy initiatives would establish a far more propitious basis than currently exists for attaining domestic and external equilibrium, raising the economy's efficiency and output, and for furthering systemic reform.

Of prime importance is the need to reduce demand pressures and to curtail the relatively rapid increases in real wages that have taken place in recent years. These have undermined external performance both directly and indirectly, through reducing incentives for enterprises to develop export markets. They are also the direct cause of a relatively high, and rising, rate of inflation. The strength of demand pressures is also the key factor from which stems the need for price controls and for continuing and pervasive administrative intervention in the allocation of resources. If the authorities' hopes for reducing the incidence of these features of the present system--and introducing a more market-oriented economic mechanism--are to be fulfilled while ensuring that inflation is contained at acceptable levels, it is essential first to curtail excess demand. This includes demand pressures that either cannot now be satisfied because of shortages or which are dissipated in the second economy.

Credit growth to enterprises is the main vehicle of monetary expansion and urgently needs to be limited: any other measures to restrain the growth of prices and incomes, while perhaps necessary complements in the short run, are likely to prove ineffective as long as aggregate financial policies continue to be as permissive as in the recent past. The planned decentralization of the banking system makes it all the more important to have in place effective instruments of monetary control. In this context the staff urges the authorities to proceed rapidly with their plans, now under consideration for 1988, to introduce positive real interest rates. At the same time it would be important to reduce very substantially the scope of concessionary interest rates. These moves would contribute to an improvement in the efficiency of investment spending--including the significant part absorbed by stockbuilding.

While firm demand management policies are a necessary condition for improved performance, they are by no means sufficient. It is also essential to create a price and exchange rate structure that will promote higher efficiency and output and ensure that an appropriate share of output is efficiently channeled into net exports. In this context, the mission welcomes the authorities' plans to continue to reform and liberalize the domestic price structure which continues to embody serious distortions, notably for energy products and certain other key production inputs. Again, though, it will be essential that firm demand management policies be in place if adjustments in relative prices and the exchange rate are not simply to be transformed into an increase in the general price level.

Regarding external policies, the staff would at this stage emphasize the need to streamline the present complex and unstable nature of the trade and payments system. A variety of export incentives coexists with wide-ranging controls on exports. Moreover, certain incentives are conferred--at rapidly increasing cost--through the budget in the form of tax relief and subsidies that would be more efficiently conferred through the exchange rate. Similarly, the staff believes that the foreign exchange retention scheme for exporters should be seen as an interim measure only and should not detract from the primacy of the exchange rate in encouraging export growth and import substitution. In addition to the changes in the exchange rate that these streamlining measures might entail, there is, of course, a need to keep the level of the exchange rate under review in light of ongoing trade performance and the economy's needed net earnings of foreign exchange. The size of any adjustments made in light of these considerations will, of course, be reduced to the extent that steps are taken to increase the effectiveness of the exchange rate as a policy instrument. The staff would, in particular, encourage the authorities to phase out the wide-ranging controls on exports in the context of a general liberalization of the trade regime.

There is a close relationship between the effectiveness of exchange rate and other pricing measures and systemic reform. Unless administrative intervention in the allocation of resources is reduced, such measures will have only limited impact. And, as argued above, a reduced role for administrative mechanisms will only be possible if aggregate demand is firmly controlled. The success of pricing measures also depends on enterprises having the incentive to respond to altered price signals and being subject to sanctions if they do not. A strengthening of financial discipline is therefore indispensable and would, inter alia, involve the introduction of a more uniform and stable system of enterprise taxation, a reduction in budgetary subsidies, and the application of stricter criteria in the granting of bank credit. In addition, strengthening of financial discipline would be greatly facilitated by a rigorous application of the existing legal provisions for liquidating unprofitable enterprises.

The staff realizes that implementation of measures of the type described above faces a number of potential obstacles. In particular, starting from a position in which prices and market pressures are subject to widespread distortions, there are powerful forces in favor of responding to problems in an ad hoc and piecemeal manner. If the difficulties that have afflicted earlier efforts to bring about fundamental improvements in the operation of the Polish economy are to be avoided, these pressures need to be resisted. Inevitably, the introduction of price reform measures and the strengthening of financial discipline will entail short run costs as unprofitable operations are discontinued.

These costs can be reduced--but in practice will be by no means eliminated--to the extent that the mobility of factors of production can be enhanced. The authorities should be ready to face these costs and to withstand the pressures which they will inevitably bring for an easing of policies. A sustained application of the recommended policies would, in the staff's view, both facilitate the achievement of the authorities' domestic objectives and provide a basis for a progressive normalization of Poland's external economic relations.

It is recommended that the next Article IV consultation with Poland be held on the standard 12-month cycle.

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 1987 Article XIV consultation with Poland, in the light of the 1987 Article IV consultation with Poland conducted under Decision No 5392 - (77/63), adopted April 19, 1977, as amended (Surveillance Over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions, and the multiple currency practices which are described in detail in SM/87/.., are maintained by Poland in accordance with Article XIV. The Fund notes the complexity of Poland's exchange system and urges the authorities to take early steps to relax exchange restrictions evidenced by payments arrears and bilateral payments arrangements, and encourages the authorities to eliminate the restrictive multiple currency practices in the near future.

Table 1. Poland: Selected Economic Indicators, 1981-87

(Percentage change unless otherwise indicated)

	1981	1982	1983	1984	1985	1986	Official Forecast 1987
Domestic indicators							
(In real terms)							
Gross domestic product (SNA basis)	-10.0	-4.8	5.6	5.6	3.6	5.1	...
Net material product	-12.0	-5.5	6.0	5.6	3.4	5.2	2.4
Consumption (material)	-4.6	-11.5	5.8	4.4	2.9	4.7	2.5
Gross fixed investment	-19.1	-13.7	8.8	9.8	4.4	4.3	3.3
Industrial production (gross)	-10.8	-2.1	6.4	5.2	4.5	4.7	...
Agricultural production (gross)	3.8	-2.8	3.3	5.7	0.7	4.9	—
(In nominal terms)							
Consumer prices	21.2	100.8	22.1	15.0	15.1	17.8	19.0-20.0
Average monthly wages in the socialized sector	27.3	51.3	24.5	16.3	18.8	20.4	17.0-18.0
Household incomes 1/	31.3	66.1	22.4	18.3	18.4	22.2	20.0
Fiscal indicators							
State budget revenues	-5.4	109.4	12.6	25.7	24.1	22.4	17.1 2/
State budget expenditures	17.7	75.5	11.0	26.1	20.9	22.3	13.9 2/
State budget balance (as a percentage of GDP)	-11.4	-2.9	-2.1	-2.2	-1.2	-1.1	— 2/
Direct subsidies (as a percentage of total expenditures)	58.0	44.6	40.0	41.4	39.6	39.7	38.2
Monetary indicators							
Domestic credit (net of general government deposits) 3/	18.1	20.4	10.7	10.7	17.2	19.5	17.0 4/
Money and quasi-money	24.1	36.7	14.5	18.7	24.2	25.1	21.0
External indicators in convertible currencies (in terms of U.S. dollars)							
Exports 5/	-32.5	-8.6	5.8	10.8	-3.8	3.8	4.4
Imports 5/	-29.0	-26.2	-9.0	1.4	2.2	6.2	5.1
Trade balance							
In billions of U.S. dollars	-0.82	0.27	0.92	1.38	1.09	1.04	1.05
In percent of GDP 6/	-1.5	0.4	1.2	1.8	1.5	1.4	1.6
Current account							
In billions of U.S. dollars	-3.19	-2.27	-1.41	-0.77	-0.62	-0.67	-0.80
In percent of GDP 6/	-5.9	-3.5	-1.9	-1.0	-0.9	-0.9	-1.2
External debt (end of period)							
In billions of U.S. dollars	25.9	26.5	26.4	26.9	29.7	33.5	34.5 7/
In percent of GDP 6/	48.2	40.5	34.9	35.7	41.8	45.4	53.9
External arrears							
In billions of U.S. dollars	3.6	6.8	10.7	12.1	0.8	3.4	...
Commercial exchange rate depreciation (-) against U.S. dollar	-13.6	-39.6	-7.4	-19.4	-22.7	-16.0	...
External indicators in nonconvertible currencies (in terms of U.S. dollars) 8/							
Exports 6/	-11.5	7.7	4.7	4.6	-10.6	7.8	...
Imports 6/	-3.9	-5.8	4.9	4.9	-8.7	3.6	...
Current account balance (in billions of U.S. dollars)	-1.21	-0.36	-0.35	-0.51	-0.53	-0.28	—

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

1/ Income accruing from savings bonds issued in 1982 (to provide partial compensation to savers for the large increase in prices in that year) is distributed over the period 1982-85 even though the bonds and accumulated interest income could not be encashed before 1985.

2/ Budget figures. In April a package of cost savings measures was introduced to offset the projected overrun in expenditure—largely in subsidies—and shortfall in revenue if current trends were to continue.

3/ Excluding settlements with State Budget.

4/ To the socialized sector (excluding general government) only.

5/ Balance of payments basis.

6/ Gross domestic product in zloty terms is converted into U.S. dollars at the commercial exchange rate.

7/ Excludes valuation adjustments resulting from exchange rate fluctuations.

8/ Transactions in nonconvertible currencies were converted from transferable rubles into zlotys at the TR/Zl commercial rate, and then into U.S. dollars at the Zl/US$ commercial rate.

Table 2. Selected Social and Demographic Indicators

Area

Size: 312.7 thousand sq. km.
Agricultural land (in percent of total area): 60
Population per sq. km: 120

Population characterisics

Total population (end-1986): 37.5 million
Population of working age (end-1986): 21.8 million
Average annual rate of growth in 1985-86 (percentage change): 0.7
Life expectancy at birth (1985):
  Male: 66.5 years
  Female: 61.3 years
Population death rate (1986; in percent): 1

Per capita income (1986): US$1,976

Health (1986)

Population per physician: 499
Population per hospital bed: 176

Education (1986)

Population between the ages of 15-18 that are in school
  (in percent): 84

Source: Rocznik Statystyczny; various issues.

Table 3. Poland: Development of Selected Indices, 1970-86

	(1970 = 100)			(1978 = 100)	
	1978	1982	1986	1982	1986
Real net material product	184.1	140.6	171.1	76.5	93.1
Industry	201.0	154.5	187.3	76.9	93.2
Agriculture	115.5	98.0	115.2	84.9	99.8
Construction	192.3	95.6	120.6	49.7	62.7
Consumption 1/	179.0	159.0	189.4	88.8	105.8
(Consumption per capita) 1/	(167.3)	(143.4)	(165.2)	(85.7)	(98.9)
Gross fixed investment 1/	227.3	129.0	167.9	56.8	73.9
Average real household disposable incomes 2/	192.3	181.5	199.8	94.4	103.9
Real wages in the socialized sector 2/	163.1	136.2	148.2	83.5	90.9
Consumer prices	134.1	382.0	727.3	284.9	542.4
Employment	112.7	112.0	113.5	99.3	100.7
Exports (in volume terms) 3/					
To nonsocialist countries	178.0	150.0	174.2	84.3	97.9
To socialist countries	208.6	200.2	277.4	96.0	133.0
Imports (in volume terms) 3/					
From nonsocialist countries	319.6	147.1	187.3	46.0	58.5
From socialist countries	186.9	172.2	224.6	92.1	120.2

Sources: Central Statistical Office, Rocznik Statystyczny 1986; and data provided by the authorities.

1/ In volume terms.
2/ Deflated by the consumer price index.
3/ Customs basis.

Table 4. Poland: Demand and Supply

(Percentage change at constant prices)

	Annual Average 1971-75	Annual Average 1976-79	Annual Average 1980-82	Annual Average 1983-84	1985	1986	Official Forecast 1987
Net material product 1/							
Private consumption	8.5	4.8	-5.9	5.0	2.2	4.6	2.6
Government consumption	9.8	6.3	1.2	5.7	6.7	5.2	1.4
Fixed investment	19.6	-4.6	-23.2	10.9	4.9	5.3	3.3
Stockbuilding 2/	1.5	-1.2	-0.4	-0.7	0.6	0.2	--
Domestic expenditure	11.6	1.3	-9.0	5.3	3.8	4.7	2.4
Exports 3/	10.9	6.1	-4.6	10.5	0.3	3.9	2.3
Imports 3/	17.5	2.2	-11.7	7.6	6.9	3.3	2.4
Net material product	9.8	3.1	-7.9	5.8	3.4	5.2	2.4
Of which:							
Industry	10.8	4.3	-7.9	5.6	4.0	4.5	...
Agriculture	1.3	0.4	-2.6	5.7	0.2	6.1	-1.7
Construction	12.4	-0.2	-18.6	7.9	4.3	3.9	...
GDP (SNA basis)							
Gross domestic expenditure	...	...	...	5.1	3.9	4.7	2.3-2.4
GDP	...	...	...	5.6	3.6	5.1	2.3-2.4

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

1/ Net material production is equivalent to GDP less depreciation and the value added of nonmaterial services, plus nonmaterial services used as inputs in material production.
2/ Expressed in terms of contributions to growth of NMP.
3/ Of goods and material services through 1986; for 1987, trade in goods only.

Table 5. Poland: Balance of Payments in Convertible Currencies, 1981-86 1/

(In millions of U.S. dollars)

	1981	1982	1983	1984	1985	1986	Official Forecast 1987
A. Current account	-3,185	-2,272	-1,412	-774	-618	-665	-800
Merchandise exports, f.o.b.	4,971	4,543	4,806	5,324	5,120	5,316	5,550
Merchandise imports, f.o.b.	5,793	4,275	3,890	3,944	4,032	4,281	4,500
Trade balance	-822	268	916	1,380	1,088	1,035	1,050
Services: credit	770	557	772	713	722	773	750
Shipment and other transportation	348	256	388	262	270	275	...
Travel	95	59	69	81	86	96	...
Interest receipts	151	84	153	180	165	177	150
Other	176	158	162	190	201	225	...
Services: debit	3,787	3,415	3,475	3,329	3,192	3,417	3,400
Shipment and other transportation	322	224	425	411	393	399	...
Travel	32	23	24	25	31	37	...
Interest payment obligations (before debt relief)	3,316	3,031	2,889	2,729	2,609	2,734	2,850
Paid	(2,243)	(1,830)	(1,587)	(1,245)	(1,231)	(1,147)	(...)
Rescheduled	(477)	(—)	(—)	(—)	(828)	(87)	(...)
In arrears	(596)	(1,201)	(1,302)	(1,484)	(550)	(1,500)	(...)
Other	117	137	137	164	159	247	...
Unrequited transfers (net)	654	318	375	462	764	944	800
Private	331	318	375	462	764	944	...
Official	323	—	—	—	—	—	...
B. Medium- and long-term capital account (net)	666	-3,021	-2,526	-1,844	245	-1,850	-2,125 2/
Drawings on loans	4,919	1,474	565	218	261	294	325
Loan repayment obligations (before debt relief) 3/	6,037	6,701	4,242	2,758	2,391	3,458	2,250
Paid	(1,397)	(368)	(508)	(364)	(756)	(715)	(...)
Rescheduled	(1,634)	(2,208)	(1,154)	(779)	(1,559)	(1,443)	(...)
In arrears	(3,006)	(4,125)	(2,580)	(1,615)	(76)	(1,300)	(...)
Debt relief 3/	2,111	2,208	1,154	779	2,387	1,530	...
Principal	(1,634)	(2,208)	(1,154)	(779)	(1,559)	(1,443)	(...)
Interest	(477)	(—)	(—)	(—)	(828)	(87)	(...)
Export credits extended (net)	-328	-1	-5	-85	-13	-211	-200
Other capital (net)	1	-1	2	2	1	-5	—
C. Short-term capital and other items (net)	-1,048	336	175	-141	99	-367	-375
Of which: *Revolving credits*	(—)	(196)	(338)	(240)	(-2)	(139)	(...)
D. Overall balance (Items A through C)	-3,567	-4,957	-3,763	-2,759	-274	-2,882	-3,300
E. Change in reserves (-, increase)	-35	-369	-119	-340	236	173	—
F. Change in arrears 4/	3,602	5,326	3,882	3,099	38	2,709	...
Incurrence of new arrears	3,602	5,326	3,882	3,099	626	2,800	...
Cash settlement of arrears	—	—	—	—	588	91	...
Memorandum items:							
Stock of arrears (end of period)	3,602	6,778	10,660	12,072	847	3,412	
Regularization of arrears through rescheduling 3/	—	2,150	—	1,687	10,933	144	
Valuation and other adjustments	...	...	...	...	-330	—	

Source: Staff compilation from data provided by the Polish authorities.

1/ Transactions within swing limits under bilateral payments agreements with non-CMEA countries are excluded.

2/ Excluding any debt relief obtained.

3/ For purposes of this presentation debt relief in the current period is recorded in the year in which rescheduled payments were originally due rather than in the year in which the agreement was signed.

4/ Arrears to Paris Club creditors are treated as having been regularized on the signature of the relevant multilateral agreements. Two (five) bilateral agreements remain to be signed with respect to the consolidation of 1982-84 (1985) maturities.

Table 6. Poland: External Trade

(Percentage change)

	Annual Average 1971-75	1976-79	1980-82	1983-84	1985	1986	Jan.-May 1/ 1987
Nonruble trade							
Volume of exports	9	4	-7	14	-4	2	6
Volume of imports	26	-1	-20	10	11	3	7
Terms of trade	3	—	1	-4	5	1	6
Ruble trade							
Volume of exports	11	8	-4	7	7	9	6
Volume of imports	8	7	-4	4	6	6	—
Terms of trade	—	-1	-4	-2	-1	1	4

	1970-71 to 1976-78	1976-78 to 1979-80	1980 to 1981	1981 to 1986	1985 to 1986
Change in export market shares 2/ (In percent)	+15	-18	-33	+4	+3

Sources: Data provided by the Polish authorities; and IMF, Direction of Trade.

1/ Over first five months of 1986.
2/ Share of Polish exports in total world imports (excluding imports of CMEA area) from non-oil developing and CMEA countries, in current prices.

Table 7. Poland: External Debt

(In billions of U.S. dollars; end-period)

	1981	1982	1983	1984	1985	1986	March 1987
In convertible currencies							
Short-term	1.1	1.3	1.3	1.3	1.4	1.4	1.5
Medium- and long-term	24.3	23.6	22.4	21.5	23.9	28.8	30.4 1/
By maturity:							
1-5 years	10.9	10.7	8.5	7.2	6.7	5.2	5.3
Over 5 years	13.4	12.9	13.9	14.3	17.2	23.6	25.1
By type and by creditor							
Guaranteed	12.5	12.2	13.6	14.0	15.7	18.9	20.1
Countries participating in the Paris Club 2/	(10.8)	(10.7)	(11.3)	(10.7)	(12.0)	(15.9)	(17.1)
CMEA countries and institutions	(0.1)	(0.1)	(1.0)	(1.3)	(1.3)	(1.4)	(1.4)
Commercial credits 3/	(1.2)	(1.3)	(1.1)	(1.3)	(1.6)	(1.4)	(1.4)
Other	(0.4)	(0.1)	(0.2)	(0.7)	(0.8)	(0.2)	(0.2)
Nonguaranteed	11.8	11.4	8.8	7.5	8.2	9.9	10.3
Commercial banks participating in rescheduling arrangements 4/	(8.6)	(8.0)	(6.5)	(6.1)	(6.6)	(7.5)	(7.9)
CMEA countries and institutions	(1.9)	(1.8)	(0.8)	(0.9)	(1.0)	(1.1)	(1.1)
Commercial credits 3/	(0.5)	(0.6)	(0.5)	(0.1)	(0.2)	(0.2)	(0.2)
Other	(0.8)	(1.0)	(1.0)	(0.4)	(0.4)	(1.1)	(1.1)
Interest arrears 5/	0.5	1.6	2.7	4.1	4.4	3.3	3.1
Total	25.9	26.5	26.4	26.9	29.7	33.5	35.0
In noncovertible currencies 6/							
Short-term	1.0	0.5	0.2	0.6	—	0.1	0.1
Medium- and long-term	1.6	2.4	2.5	2.2	3.4	4.1	3.1
Of which:							
1-5 years	(0.7)	(0.7)	(0.6)	(0.3)	(1.0)	(0.7)	(0.5)
Over 5 years	(0.9)	(1.7)	(1.9)	(1.9)	(2.4)	(3.4)	(2.6)
Total	2.6	2.9	2.7	2.8	3.4	4.2	3.2
Memorandum item:							
Ratio of average debt stock in convertible currencies to exports in convertible currencies	5.0	5.8	5.5	5.0	5.5	5.9	

Source: Staff compilation from data supplied by the Polish authorities.

1/ Currency of denomination was as follows: U.S. dollar, 37.1 percent; Deutsche mark, 23.6 percent; Swiss franc, 12.9 percent; French franc, 8.5 percent; Austrian schilling, 7.2 percent; pound sterling, 3.1 percent; Canadian dollar, 2.0 percent; Japanese yen, 2.8 percent; other currencies, 2.8 percent.

2/ Includes Brazil, which did not participate in the 1981 rescheduling agreement with the Paris Club.

3/ Commercial credits guaranteed and nonguaranteed include credit extended by foreign banks as well as by foreign exporters to Polish foreign trade enterprises. The guaranteed portion is covered by Paris Club negotiations.

4/ In addition to these data, a small amount of obligations due to CMEA banks operating in the West (US$0.3 billion at end-1986) and commercial credits (US$0.2 billion at end-1986) have been included in the rescheduling agreements with commercial banks (see Table 8).

5/ Estimate. Includes amounts that are covered by multilateral rescheduling agreements (and which therefore are not shown as arrears in Table 8) but for which bilateral agreements have yet to be signed. At end-1986 virtually all these arrears were vis-à-vis Paris Club creditors.

6/ The external debt in nonconvertible currencies was converted from transferable rubles into U.S. dollars using cross rates derived from the commercial rates of the zloty vis-à-vis the transferable ruble and U.S. dollar; prior to 1982 the period average exchange rate was used.

Table 8. Poland: Maturity Schedule of Medium- and Long-Term External Debt in Convertible Currencies Outstanding at End-1986

(In millions of U.S. dollars)

	Debt Outstanding at End-1986 1/	1987	1988	1989	1990	1991	1992	1993	Later Years	Delayed
Paris Club creditors	20,470 2/	1,233	1,198	1,040	2,152	2,306	2,380	2,248	4,578	3,335
Previously rescheduled debt	17,025	694	695	695	1,879	2,161	2,161	2,161	4,321	2,258
Nonrescheduled debt	3,445	539	503	345	273	145	219	87	257	1,077
Commercial banks participating in rescheduling agreements	8,027 3/	473	1,589	1,294	1,795	1,850	610	400	10	6
Previously rescheduled debt	7,576	335	1,558	1,226	1,626	1,839	599	393	—	—
Nonrescheduled debt	451	138	31	68	169	11	11	7	10	6
CMEA	2,219	129	148	65	59	306	325	302	876	9
Commercial credits	187	97	60	26	3	1	—	—	—	—
Other	1,233	318	235	190	174	34	128	18	74	62
Total	32,136	2,250	3,230	2,615	4,183	4,497	3,443	2,968	5,538	3,412

Source: Staff compilation based on data supplied by the Polish authorities.

1/ Including interest arrears.
2/ Including interest arrears and obligations classified as "commercial credits (guaranteed)" in Table 11.
3/ Including US$0.3 billion of obligations with CMEA banks operating in the West which are classified in Table 11 with "CMEA countries and institutions (nonguaranteed)" and US$0.2 billion of "commercial credits (nonguaranteed)" which are classified separately in Table 11.

Table 9. Poland: Balance of Payments in Nonconvertible Currencies, 1981-86 1/2/

(In millions of U.S. dollars)

	1981	1982	1983	1984	1985	1986
Current account	-1,212	-356	-348	-505	-528	-283
Merchandise exports, f.o.b.	5,493	5,914	6,194	6,476	5,792	6,242
Merchandise imports, f.o.b.	6,771	6,379	6,692	7,018	6,404	6,633
Trade balance	-1,278	-465	-498	-542	-612	-391
Services: credit	489	519	590	517	548	587
Shipment and other transportation	345	373	384	319	293	305
Travel	10	9	12	17	27	35
Interest receipts	20	8	31	15	11	11
Others	114	129	163	166	217	236
Services: debit	424	415	445	485	468	481
Shipment and other transportation	83	73	76	81	85	93
Travel	174	110	168	196	143	139
Interest payments	79	125	85	104	121	117
Others	88	107	116	104	119	132
Unrequited transfers (private)	1	5	5	5	4	2
Medium- and long-term capital, net	328	18	-110	-67	72	176
Credits received	413	-63	-77	-8	63	187
Drawings	587	1,114	446	409	462	818
Repayments	174	1,177	523	417	399	631
Credits extended	-99	70	-46	-73	-4	-22
Repayments	52	147	66	60	52	59
Drawings	151	77	112	133	56	81
Other capital, net	14	11	13	14	13	11
Short-term capital, net	933	279	463	551	385	129
Credits received	1,044	561	148	633	396	284
Credits extended	—	—	—	—	—	—
Payments agreement assets and liabilities	-111	-282	315	-82	-11	-155
Financial items, net	-49	59	-5	21	101	-22
Total	—	—	—	—	—	—

Source: Staff compilation from data supplied by the Polish authorities.

1/ Data have been converted from transferable rubles into U.S. dollars using the ratio of the Polish commercial exchange rates for the two currencies.

2/ Including transactions within swing limits under bilateral payments agreements with non-CMEA countries.

Table 10. Poland: Major Budgetary Aggregates, 1980-87

(In percent of GDP at current prices)

	1980	1982	1983	1984	1985	1986	Budget 1/ 1987
Total state budget revenue	48.3	43.4	39.1	39.7	40.4	40.0	37.8
Of which:							
Turnover tax 2/	16.6	11.5	13.8	13.6	12.3	11.7	11.4
Income tax 2/	7.5	13.8	9.1	8.8	10.7	11.1	12.5
Total state budget expenditure	49.5	46.3	41.2	41.9	41.6	41.1	37.8
Of which:							
Purchases of goods and services and payments of wages	7.2	7.3	7.0	7.0	7.0	7.0	8.0
Subsidies to the population	11.9	10.3	8.3	8.7	8.2	9.2	8.5
Subsidies to enterprises	16.7	10.3	8.1	8.6	8.2	7.1 3/	6.0
Investment	4.2	4.8	5.5	5.3	5.7	5.9	5.6
State budget balance	-1.2	-2.9	-2.1	-2.2	-1.2	-1.1	--
Extrabudgetary funds balance	-0.7	0.4	1.3	1.7	1.2	0.8	-0.1
General government balance	-1.9	-2.5	-0.8	-0.5	--	-0.3	-0.1

Source: Staff compilation from data provided by the authorities.

1/ GDP based on official projections of real output growth and inflation.
2/ On the socialized sector.

Table 11. Poland: Selected Data on Money and Credit, 1981-86

	1981	1982	1983	1984	1985	1986
			(Percent change)			
Domestic credit	21.1	19.7	13.3	13.0	19.5	24.3
Socialized sector	7.3	14.6	9.4	9.5	16.6	18.9
Working capital credits	(8.9)	(17.6)	(7.7)	(6.8)	(21.0)	(18.3)
Investment credits	(5.8)	(11.7)	(11.3)	(12.2)	(12.3)	(19.6)
Nonsocialized entities and households	5.7	35.2	31.8	23.5	26.5	25.2
Net claims on government 1/						
Excluding settlements with state budget	138.3	57.2	-12.1	1.7	-24.2	-17.7
Including settlements with state budget 2/	(72.3)	(-87.3)	(-600.0)	(147.9)	(34.4)	(122.7)
Money (M1)	22.3	39.1	10.0	16.3	21.4	19.7
Socialized sector	(12.3)	(31.8)	(4.4)	(16.0)	(18.1)	(22.0)
Nonsocialized sector	(43.2)	(51.1)	(18.1)	(16.6)	(25.6)	(17.0)
Broad money (M2)	24.0	36.7	14.5	18.7	24.2	25.1
Socialized sector	(9.6)	(34.4)	(5.6)	(18.7)	(7.8)	(20.5)
Nonsocialized sector	(36.8)	(38.4)	(20.7)	(18.8)	(34.2)	(27.3)
Broad money (in real terms) 3/	1.8	-37.6	-1.8	2.3	6.7	6.1
			(Contribution in percentage points to growth in broad money)			
Credit to the socialized sector	14.8	25.7	13.9	13.3	21.5	23.1
Credit to nonsocialized entities and households	0.6	3.2	2.8	2.4	2.8	2.7
Credit to government, net	22.8	6.2	3.9	4.3	2.1	8.0
Credit to government, excluding settlements with state budget 1/	22.8	6.5	-0.4	0.1	-0.7	-0.5
State budget	(23.9)	(8.0)	(3.0)	(5.1)	(0.4)	(4.4)
Extrabudgetary funds	(-1.1)	(-1.5)	(-3.5)	(-5.0)	(-1.1)	(-4.9)
Settlements with state budget 2/	--	-0.4	4.4	4.2	2.8	8.5
Total domestic credit	38.3	35.0	20.7	20.0	26.4	33.8
Foreign assets, net	2.6	-1.2	-1.3	-1.8	0.1	2.6
Other liabilities, net	-16.9	2.9	-4.9	0.5	-2.4	-11.3
Rate of change of broad money	24.0	36.7	14.5	18.7	24.2	25.1
			(Ratio)			
Income velocity of broad money						
Held by the socialized sector 4/	1.99	4.12	4.37	4.77	5.08	5.50
Held by nonsocialized entities and households 5/	2.06	2.46	2.35	2.32	2.25	2.06
			(In percent)			
Average interest rates						
Deposits of the socialized sector	1.8	2.7	2.4	2.8	2.1	2.1
Deposits of the nonsocialized sector	5.2	8.1	8.1	8.3	7.6	7.6
Credits to the socialized sector	5.0	5.4	6.0	5.9	6.4	6.4

Source: Staff compilation from data provided by the authorities.
1/ Includes state budget, local governments, and extrabudgetary funds.
2/ Excludes valuation adjustments for foreign currency fluctuations.
3/ Deflated by the GMP deflator.
4/ Ratio of NMP of the socialized sector to the average stock of broad money held by the socialized sector.
5/ Ratio of disposable household income to the average stock of broad money held by the nonsocialized sector.

Table 12. Poland: Official Medium-Term Balance of Payments Projections in Convertible Currencies, 1987-92

(In millions of U.S. dollars at current prices unless otherwise indicated)

	1987	1988	1989	1990	1991	1992
1. Current balance	-800	-800	-550	-350	50	300
Trade balance	1,050	1,250	1,500	1,800	2,150	2,350
Exports	(5,550)	(5,050)	(6,600)	(7,250)	(8,000)	(8,650)
Imports	(4,500)	(4,800)	(5,100)	(5,450)	(5,850)	(6,300)
Net services	-2,650	-2,800	-2,800	-2,900	-2,950	-2,900
Receipts	750	830	920	960	1,000	1,090
Of which:						
Interest receipts	(150)	(150)	(200)	(200)	(200)	(250)
Payments	-3,400	-3,630	-3,720	-3,860	-3,950	-3,990
Of which:						
Interest obligations	(-2,850)	(-2,933)	(-3,022)	(-3,094)	(-3,149)	(-3,170)
Private transfers (net)	800	750	750	750	850	850
2. Medium- and long-term capital repayment obligations	-2,250	-3,230	-2,615	-4,183	-4,497	-3,443
3. Credit extended (net)	-200	-150	-200	-200	-200	-250
4. Change in reserves (-, increase)	—	-100	-100	-100	-100	-100
5. Balance to be financed (-1 -2 -3 -4)	3,250	4,280	3,465	4,833	4,747	3,493
Memorandum items:						
			(Percentage change)			
Merchandise exports						
Change in volume	1.6	5.8	5.9	6.6	7.1	5.0
Change in price	2.8	3.0	3.0	3.0	3.0	3.0
Merchandise imports						
Change in volume	3.8	3.6	3.2	3.8	4.2	4.6
Change in price	1.3	3.0	3.0	3.0	3.0	3.0
			(In percent)			
Average interest rate on external debt	8.4	8.4	8.4	8.5	8.5	8.5
Accrued debt service payment obligations as a proportion of receipts from exports of goods and nonfactor services (debt service ratio)	82.9	91.6	77.0	90.8	86.9	69.7
			(In billions of U.S. dollars)			
External debt in convertible currencies (at end of period)	34.50 1/	35.55	36.40	37.05	37.30	37.35

Source: Data provided by the Polish authorities.

1/ Excludes valuation adjustments resulting from exchange rate fluctuations.

Poland - Fund Relations

(As of July 31, 1987)

I. Membership Status

(a) Date of membership: Poland was an original member of the Fund but withdrew from membership in March, 1950. Poland rejoined the Fund on June 12, 1986.

(b) Status: Article XIV.

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 680 million

(b) Total Fund holdings of currency: SDR 680 million (100 percent of quota).

(c) Fund credit: none

(d) Reserve tranche position: none

III. Stand-by or Extended Arrangements and Special Facilities

No history of use of Fund credit.

IV. SDR Department

(a) Net cumulative allocation: none

(b) Holdings: SDR 79,746

V. Financial Obligations due to the Fund

	Overdue Financial Obliations (July 31)	Principal and Interest due 1987	1988	1989	1990
Principal	--	--	--	--	--
Repurchases	--	--	--	--	--
T.F. Repayments	--	--	--	--	--
Charges and Interest including SDR and TF (provisional)	--	--	--	--	--
Total	--	--	--	--	--

B. Nonfinancial Relations

VI. Exchange rate arrangements: The currency of Poland is the zloty. Commercial transactions in convertible currencies are carried out at a single exchange rate which is determined on the basis of a weighted basket of currencies, each of which accounts for at least 1 percent of Poland's external current account settlements. The value of the zloty in terms of the basket is periodically adjusted to reflect differences between changes in foreign and domestic prices with a view to ensuring that, for the majority of exports, the export price is equal to or greater than the domestic price. The currency composition of the basket and the currency weights are defined on a monthly basis in light of current account transactions in convertible currency during the previous months of the calendar year. Buying and selling rates are set with margins of 0.5 percent about the middle rate (except for notes and coins for which the margins are 2 percent), which on June 30, 1987 was Zl 262.92 = US$1. Rates are generally set at least once a week, normally on Thursdays, to become effective when they are published on the following Monday.

A single exchange rate similarly applies to commercial transactions denominated in transferable rubles and is generally fixed for extended periods; the middle rate on June 30, 1987 was Zl 115.00 = TR 1. Exchange rates are also quoted for the zloty against the currencies of CMEA member countries, Albania, and the Democratic People's Republic of Korea for the purpose of noncommercial transactions; these rates are based on multilateral and supplemental bilateral agreements.

VII. The last Article IV consultation was concluded at EBM/86/169 (October 15, 1986). Poland is on a 12-month consultation cycle. The following decision was taken by the Board on Octcober 15, 1986:

"1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Poland, in light of the 1986 Article IV consultation with Poland concluded under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions, and the multiple currency practices which are described in detail in SM/86/248, Appendix II, are maintained by Poland in accordance with Article XIV. The Fund notes the complexity of Poland's exchange system and urges the authorities to take early steps to relax exchange restrictions evidenced by payments arrears and bilateral payments arrangements, and encourages the authorities to eliminate the restrictive multiple currency practices in the near future."

VIII. Technical Assistance

Bureau of Statistics: Missions from the Bureau of Statistics visited Poland in December 1985 and May 1987. A country page for Poland was introduced in the August 1987 issue of IFS.

Poland--Exchange Practices Subject to Fund Jurisdiction

The following aspects of Poland's exchange and trade system, which were in effect on July 1, 1987, constitute restrictions on payments and transfers for current international transactions:

1. The multiple currency practices which arise with respect to the currencies of Fund members that are also members of the CMEA (viz., Hungary, Romania, and Viet Nam) as a result of the broken cross rates that may be associated with quotations for the transferable ruble.

2. The multiple currency practices which may arise with respect to the currencies of countries that are considered by Poland as market economies from the possibility that broken cross rates may emerge as a consequence of the system of weekly quotations for the exchange rates of these currencies.

3. The multiple currency practices which arise from (a) the 100 percent surcharge applied on the sale to Polish tourists traveling abroad of the currencies of countries considered as market economies; and (b) the 30 percent surcharge applied on the sale to Polish tourists traveling abroad of the currencies of certain Fund member countries considered by Poland as socialist economies (namely, Democratic Kampuchea, Hungary, Romania, and Viet Nam).

4. The multiple currency practice which arises in the event that the advance import deposit required under the system of effectiveness bids for foreign exchange results in an opportunity cost of more than 2 percent.

5. The multiple currency practice which arises from the exchange rate obtained in the auctions of rights to surplus foreign exchange retained by exporters in the ROD accounts.

6. Poland's bilateral clearing arrangements with Fund members, namely Bangladesh, Brazil, the People's Republic of China, Colombia, Ecuador, Iceland, India, the Islamic Republic of Iran, Democratic Kampuchea, Lao People's Democratic Republic, Lebanon, and Nepal. Also, Poland's trade agreements with bilateral payments features for certain commodities with Argentina, Bangladesh, Malta, Mexico, Pakistan, and Yugoslavia.

7. The joint exchange and import license, under which the decision on the granting of the license to import may be decided on the basis of the value of transaction.

8. The restriction imposed on the amount of tourist and business travel allowances.

9. The restriction imposed on the amount of education allowances for study abroad.

10. The restriction imposed on the transfer of income abroad by nonresident workers in Poland.

11. The restriction imposed on the remittance abroad of investment income (including profits).

12. The restriction in the form of a foreign exchange budget fixing the amount of exchange available for external debt service. This procedure, which is comprehensive in that it applies to debt service on the financial obligations of which the obligor is the Government, governmental entity or other resident of Poland, gives rise to payments arrears which on December 31, 1986 were estimated to total US$3,412 million.

Poland - Statistical Issues

1. Outstanding Statisical Issues

A country page for Poland was introduced in the August 1987 issue of IFS.

a. Real sector

(1) National accounts

The latest national accounts aggregate data relate to 1986 without the necessary breakdown of general government and private consumption.

(2) Prices, production, and labor

An index of net industrial product and new series for cost of living and average employment have been reported. The index of average employment has replaced the absolute employment series because of its wider coverage. Concerning retail prices, while annual revisions were provided for 1981-85, the quarterly data have not yet been revised.

Export unit value and import unit value indices will be published as soon as complete data series are received.

b. Government finance

Data on government operations are, at present, not published in International Financial Statistics (IFS) or the Government Finance Statistics Yearbook (GFS Yearbook).

A government finance statistics mission (June 15-July 1, 1987) assisted the authorities in establishing procedures for regular compilation of government finance statistics in conformity with the Fund's A Manual on Government Finance Statistics (GFS Manual). As a result, institutional tables, and derivation and statistical tables on revenue, grants, expenditure, and lending for 1986 are being prepared for the creation of a country page in the 1987 GFS Yearbook. The mission discussed the scope for further improvements to enhance the analytical value of the statistics, especially with regard to the coverage of the statistics, the remaining discrepancies between the government finance and monetary data, and the classification of expenditure, lending, financing, and debt. The compilation of quarterly and projected data was discussed with the authorities, and a provisional time frame for the communication of government finance statistics to the Bureau of Statisics was agreed.

c. Monetary accounts

Available data for the monetary system (i.e., monetary authorities and deposit money banks) cover quarterly series beginning 1986, with only end-year data available for earlier years.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Poland in the August 1987 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Ministry of Finance.

Status of IFS Data

		Latest Date in August 1987 IFS
Real sector	- National Accounts	1986
	- Prices	Q1 1987
	- Production	May 1987
	- Employment	May 1987
	- Earnings	May 1987
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	March 1987
	- Deposit Money Banks	March 1987
	- Other Financial Institutions	n.a.
Interest Rates	- Discount Rate	March 1987
	- Bank Lending/Deposit Rate	March 1987
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	1986
	Prices	1985
	- Balance of Payments	Q1 1987
	- International Reserves	May 1987
	- Exchange Rates	May 1987

Poland: Illustrative Medium Term Scenarios

To provide a framework for considering the relationship between domestic and external targets, the staff has prepared certain medium term scenarios. They are designed for illustrative purposes only and in no sense are the results to be seen as forecasts.

In the first two scenarios, the implications of achieving current account balance in convertible currencies in 1988, and thereafter maintaining a moderate surplus, are explored on the basis of alternative assumptions about the implementation of economic reform and supporting policy measures. In scenario 1, it is assumed that such measures are not introduced on a scale sufficient to raise the economy's efficiency and growth performance. In scenario 2, it is assumed that the introduction of measures does result in a significant improvement in these areas. This latter assumption is maintained in scenario 3 where a somewhat slower current account adjustment path, with the achievement of balance only in 1989, is considered. The main assumptions, the methodology, and a summary of results are presented below.

General assumptions

The main assumptions are:

a. The rate of growth of real output (GDP) is assumed to be equal to a constant term plus a term relating the change in real GDP to the change in the volume of total (convertible plus noncovertible) merchandise imports. This is intended to allow an at least notional separation of the "underlying" rate of growth of the economy (reflecting changes in the supply of domestic factors of production and their productivity) from the growth that is dependent on changes in imports. The equation used is:

$$\hat{y} = a + b. \hat{m}$$

where $\hat{y}$ = rate of growth of real GDP

$\hat{m}$ = rate of growth of the volume of total merchandise imports

a = constant term, equal to the economy's assumed 'underlying' rate of growth

b = the elasticity of output with respect to the volume of total merchandise imports.

Variations in the assumed impact of economic reform and other policy measures are reflected in changes in the values of the terms "a" and "b."

b. Assumed changes in foreign trade prices are generally based on a weighting of price projections taken from the WEO exercise in light of the commodity composition of Polish trade.

c. The average interest rate on the external debt is assumed to be 8.7 percent. A spread of about 1.4 percentage points over LIBOR (six months) is assumed for 1987--the same as in 1986--but is assumed to decline slightly in later years.

d. The evolution of merchandise trade with the nonconvertible area is taken from official Polish projections. Receipts and payments for nonfactor services with the nonconvertible area are assumed to change at the same rate as merchandise exports and imports, respectively.

e. In the convertible balance of payments, receipts and payments for nonfactor services are taken from official projections; for conversion into real terms, the price deflator is assumed to rise by 3 percent each year. The values for private transfer receipts have been exogenously imposed and are higher than those assumed in the official Polish medium term scenario. Interest receipts have been calculated by applying to the stock of foreign assets (including holdings of banks and nonbanks) an interest rate equal to the implicit rate of return on such assets in 1986.

Methodology

The starting point is a profile for the evolution of the current account balance in convertible currencies. Given the assumptions about export volumes, foreign trade prices, and other current account items, the growth in import volumes from the convertible area is derived as a residual. This is added to nonconvertible imports to give total import volume. Real GDP is derived from equation (1) above but with lower coefficients being used in scenario 1 than in scenarios 2 and 3. The residual in the national accounts is total domestic expenditure. It should be emphasized that the analysis has no implications for the division of expenditure between consumption, investment, and stockbuilding.

Specific assumptions and results 1/

Scenario 1

In scenario 1 the rate of growth of real GDP is assumed to be given by:

$$\hat{y} = 1.5 + 0.4\ \hat{m}$$

1/ The results of scenarios 1-3 are summarized in Table 13.

Table 13. Poland: Medium-Term Scenarios, 1987-1992 1/

(1986 = 100, unless otherwise indicated)

	1987	1988	1989	1990	1991	1992
Scenario 1						
(Current account balance with the convertible currency area in one year; relatively slow growth in convertible currency exports and output; no terms of trade deterioration)						
GDP (1986 prices)	102.4	103.3	104.6	107.3	110.5	113.7
Domestic absorption (1986 prices)	102.2	101.9	102.5	104.8	107.8	110.9
External indicators with the convertible currency area						
Current account (in millions of U.S. dollars)	-644	--	500	500	500	500
Export volume	102.8	104.3	105.9	107.5	109.1	110.7
Import volume	103.8	92.7	85.9	90.4	94.7	99.0
Debt service ratio (excluding arrears; in percent 2/	82.3	94.0	82.1	100.9	102.2	86.0
Scenario 2						
(Current account balance in convertible currencies in one year; relatively rapid growth in convertible currency exports and output; terms of trade deterioration)						
GDP (1986 prices)	102.4	105.5	109.3	115.1	122.0	129.3
Domestic absorption (1986 prices)	102.2	103.9	106.7	111.7	118.6	125.9
External indicators with the convertible currency area						
Current account (in millions of U.S. dollars)	-664	-	500	500	500	500
Export volume	102.8	113.1	124.4	136.8	147.8	159.6
Import volume	103.8	99.5	100.0	112.4	127.3	143.1
Debt service ratio (excluding arrears; in percent 2/	82.3	89.9	75.0	88.1	84.4	67.0
Scenario 3						
(Current account balance in convertible currencies in two years; relatively rapid growth in convertible currency exports and output; terms of trade deterioration)						
GDP (1986 prices)	102.4	107.0	111.2	114.8	121.7	129.0
Domestic absorption (1986 prices)	102.2	105.8	109.1	111.3	118.2	125.3
External indicators with the convertible currency area						
Current account (in millions of U.S.dollars)	-664	-350	--	500	500	500
Export volume	102.8	113.1	124.4	136.8	147.8	159.6
Import volume	103.8	106.8	109.5	110.9	125.8	141.7
Debt service ratio (excluding arrears; in percent 2/	82.3	90.1	75.7	88.9	85.1	67.8

Source: Staff estimates.

1/ The current account path is predetermined. Other exogenous variables include the external balance with the nonconvertible currency area, export volumes with the convertible currency area, and the interest rate applied to the external debt. Imports from the convertible currency area are derived as the residual in the external accounts. The growth of GDP is based on an exogenously given "underlying" rate of growth and an elasticity of output with respect to imports. The growth in domestic expenditure is the residual in the national accounts.

2/ For 1987 the ratio shown takes account of rescheduling agreements already concluded.