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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/14

10:00 a.m., February 5, 1990

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
G. K. Arora	
F. Cassell	
C. S. Clark	G. C. Noonan
Dai Q.	
T. C. Dawson	C. S. Warner
J. de Groote	J. Prader
E. T. El Kogali	
E. A. Evans	
E. V. Feldman	R. J. Lombardo
L. Filardo	M. A. Fernández Ordóñez
R. Filosa	
M. Finaish	
M. Fogelholm	
M. R. Ghasimi	
G. Grosche	
	T. Sirivedhin
A. Kafka	L. M. Piantini
J.-F. Cirelli	
	C. V. Santos
	J. K. Orleans-Lindsay, Temporary
	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

Also Present

IBRD: P. Nouvel, Europe, Middle East, and North Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. A. Calamitsis, Deputy Director; S. J. Anjaria, G. C. Dahl. Asian Department: B. Banerjee, G. Szapary. Central Banking Department: D. A. Scott, Deputy Director; V. Sundararajan. European Department: M. Russo, Director; P. B. de Fontenay, Deputy Director; C. Cottarelli, P. C. Hole, F. M. Lakwijk, M. Mecagni, R. J. Ossowski, M. R. S. Sebastião, T. A. Wolf. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; T. Leddy, Deputy Director; M. Allen, H. M. Flickenschild. External Relations Department: H. P. Puentes. Fiscal Affairs Department: V. Tanzi, Director; R. Holzmann, G. F. Kopits. Legal Department: W. E. Holder, Deputy General Counsel; A. O. Liuksila. Middle Eastern Department: E. B. Maciejewski, M. Zavadjil. Research Department: M. Goldstein, Deputy Director; G. Calvo, P. Gajdeczka, T. D. Lane, F. Larsen. Secretary's Department: C. Brachet, Deputy Secretary; A. Tahari. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: J. Basiuk, M. B. Chatah, A. Gronn, J. M. Jones, J.-L. Menda, P. Péterfalvy, F. A. Quirós, A. Raza, S. P. Shrestha. Assistants to Executive Directors: J. R. N. Almeida, E. C. Demaestri, A. Fanna, J. Gold, M. E. Hansen, J. Heywood, L. Hubloue, K. Ichikawa, C. Y. Legg, R. Marino, H.-J. Scheid, J.-P. Schoder, J. C. Westerweel, Yang J.

1. POLAND - 1989 ARTICLE IV CONSULTATION, AND REQUEST FOR STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1989 Article IV consultation with Poland and Poland's request for a 13-month stand-by arrangement in an amount equivalent to SDR 545 million (EBS/90/11, 1/18/90). They also had before them a letter of intent (EBS/90/3, 1/3/90) and a letter that the Managing Director had sent to Fund Governors and finance ministers of Fund members that were major creditors of Poland (EBS/90/18, 1/31/90), a statement by the staff at EBM/90/10 (1/22/90) on the closing of Poland's financing gap, and a background paper on recent economic developments in Poland (SM/90/18, 1/23/90). As background information, they had before them a study on market-oriented reform in planned economies (SM/89/202, 10/5/89), and staff papers on the reform experience in China (SM/89/205, 10/6/89), Hungary (SM/89/203, 10/5/89), and Poland (SM/89/204, 10/6/89).

The staff representative from the European Department made the following statement:

> The Polish authorities have provided additional information on developments in 1989 as a whole and in January 1990.
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> Industrial output continued to decline in the final months of 1989, and for the year as a whole sold production of industry was down 3.4 percent from a year earlier. Average employment in the five main areas of the socialized sector declined by almost 5 percent for the year as a whole. The average wage in these five main branches in December was closely in line with official expectations. However, the rate of growth of prices at the retail level in December--17.7 percent--was considerably lower than the earlier official projection of 28 percent. For the year as a whole, retail prices increased at an annual average rate of 245 percent, and by 640 percent within the year.
>
> Mainly as the result of better than expected developments in the trade balance in the last two months of 1989, the current account deficit in convertible currencies for the year as a whole, at about $1,850 million, was some $175 million less than estimated in the staff report. Most of this reduction reflects a lower level of imports. Correspondingly, the trade surplus in convertible currencies declined less in 1989 than originally projected--by $700 million, to nearly $250 million.
>
> Poland paid nearly $1.1 billion of interest and $0.5 billion of principal out of total convertible currency debt service due in 1989 of $5.2 billion. New medium- and long-term loan disbursements amounted to $225 million and net repayments of credits extended by Poland totaled $75 million, but these capital inflows

were roughly matched by a negative balance in the short-term capital account (including errors and omissions). For the year as a whole, and after taking into account the BIS bridge loan of $215 million arranged in December, Poland's gross official reserves increased by some $260 million.

In the first 20 days of January, credit to nongovernment fell slightly, suggesting weak credit demand in a situation in which monthly interest rates on commercial credits ranged upward of 40 percent. Broad money, including foreign currency deposits valued at the new official exchange rate, fell in this period by 3.5 percent, with zloty money holdings increasing by almost 20 percent while foreign currency deposits declined by $850 million, reflecting both conversion into zlotys and payments for imports. Prices rose rapidly in the first part of January, but reportedly have since stabilized somewhat; the authorities expect a sharply lower rate of inflation in February and in line with the programmed path have accordingly lowered the monthly refinancing rate of the National Bank of Poland from 36 percent for January to 20 percent from February 1.

For the first 20 days of January the U.S. dollar traded in the parallel market at a discount of 1.7 percent from the official exchange rate of Zl 9,500 per U.S. dollar. Gross official reserves were unchanged over this period, and no use was made of the Stabilization Fund.

Mr. Filosa made the following statement:

I would like to express my Polish authorities' and my own personal appreciation to the staff for the imaginative approach, the extensive work, and extremely constructive spirit of collaboration with which the consultations and the negotiations have been conducted. I also wish to extend the deep appreciation of my Polish authorities to the Managing Director, who devoted his personal attention to these critical negotiations.

The program that has been agreed is indeed of particular relevance, for it encompasses major shifts in policy to be implemented under adverse conditions and in the context of important transformations of the Polish society. The policy approach adopted by the Government is rapid and comprehensive; it represents a unique and brave innovation sized on the historic challenge faced by the Polish authorities, committed to swiftly transforming their economy into a market-oriented one.

The period of adjustment is certainly going to be difficult and will cause hardship for the population. This was and is a major concern for the authorities and reinforced their belief that the transformation has to be as radical and as quick as possible in order to shorten the period of most acute difficulties.

I wish to join the staff in recognizing the courage and resolution of the authorities in embarking on this historic transformation, which is undoubtedly not exempt from risks. The authorities certainly do not underestimate the risks involved in pursuing this radical shift in policy. In deciding the courageous reshaping of their economy and society, they counted and count on the vast popular favor enjoyed by the Government, on international political and financial support, and on the pivotal and catalytic role that the Fund will play in this context.

The program we are discussing today is the basis of a profound transformation which will shape, in many respects, the future of the country. It is for the first step of this important journey that today Poland is seeking financial support from the Fund. Actually, Poland has already started receiving the support of the international community. The Polish authorities wish to express their gratitude for the prompt generosity of those Governments which contributed to the Stabilization Fund and for the cooperation of the central banks and of the U.S. Treasury which made the bridge loan through the BIS possible. They also wish to express their thankfulness to the European Community and the group of 24 countries convened by the EC Commission for its tangible help.

The financial support from the Fund maintains the Fund's character of official imprimatur for the financing of this country's transformations. The Board's approval of the stand-by arrangement will pave the way to the already planned negotiations with the Paris Club and the commercial banks, from which the Government is confident that it will obtain the necessary positive results. The Polish authorities are also receiving significant World Bank support.

In the future, they intend to continue relying on the financial support of the Fund and to solicit additional resources to be used in debt and debt-service reduction operations so as to effectively continue down the road of economic transformation and growth resolutely undertaken with the program for 1990.

In the following paragraphs, I would like to highlight the main avenues along which this economic transformation is intended to take place, starting with those emergency measures adopted at the end of last year.

It did not take long before the new Government's intention to quickly and profoundly transform the economy became clear. The new coalition Polish Government took office on September 12, 1989. Less than one month later, on October 9, the Council of Ministers approved the main guidelines of an economic program to address quickly, and through radical changes, the problems that past half-hearted and partial reforms had not solved.

As a first step of the program, a number of emergency measures were implemented in the fourth quarter of 1989 to reverse the rapid deterioration of the economy that took place in the early part of the year. To this end, wage indexation provisions were modified, and bonuses that were to be paid to workers in the fourth quarter of 1989 were suspended, thus stopping excessive real wage growth. As a result, real wages dropped significantly, limiting the increase for the year as a whole to less than one third of the first three quarters' growth. In the budgetary field, expenditure cuts and accelerated tax payments limited the budget deficit to 8 percent of GDP, compared to a prospective level of 10-11 percent. Beginning in the second half of the year, credit policy was drastically tightened, reducing net domestic credit in real terms by more than 60 percent in the year as a whole. In particular, during the second semester, credit to the government sector dropped by more than 70 percent in real terms, compared with growth of 200 percent in the first half of the year. To pave the way for the future unification of the exchange rate markets, the official exchange rate was significantly depreciated. The spread between the official and parallel markets was reduced to unprecedented levels.

The measures in the last quarter of 1989 were adopted with full awareness that they would have been only the first step in correcting the persisting and pervasive imbalances and weaknesses of the Polish economy, and that only a courageous breakthrough to match the historic challenge faced by Poland would have allowed the country to build a modern market economy corresponding to social expectations.

Therefore, as a second step of the reform strategy, the Polish Government has set forth a wide-ranging stabilization cum reform program, for which it seeks financial support from the Fund. This program is aimed at drastically and decisively reducing inflation, stabilizing the economy, and transforming it by moving to market mechanisms. Its ultimate goals are those of achieving, as early as possible, the sustained growth of output and living standards, and the decisive strengthening of the medium-term external position of Poland.

The Polish authorities have unambiguously dismissed gradualism from the possible options at their disposal for designing the program. A gradual approach would have had the sole effect of unduly prolonging the hardship on society of the temporary negative effects of the adjustment program. Moreover, a gradual phasing-in of the policies would have certainly proved ineffective to fight inflation, sustain a stable exchange rate market, and establish financial discipline in the economy.

The Polish authorities have realized that the failure experienced from the partial reforms of the 1980s dictates the need to proceed with thorough changes needed to shift to market mechanisms. The program therefore envisages the dismantling of most of the remaining price controls, the drastic reduction of subsidies, tax reliefs and exemptions, the liberalization of the foreign exchange market and trade system, and the introduction of a wide range of market-oriented institutions and mechanisms to foster efficient resource allocation and to gradually establish effective competition.

The Polish authorities intend to develop, and indeed have already started implementing, a comprehensive system of indirect instruments for macroeconomic control aimed at rapidly abating inflation, and to restore financial discipline, both at the macro and micro levels. In this respect, the Polish Government is convinced that the high rate of open inflation does not stem solely, or even mainly, from the price liberalization process. Price liberalization measures, on their own, do not lead to sustained and prolonged inflation unless accompanied by inappropriate macroeconomic management. The restoration of internal and external balances is, in the final analysis, an issue of macroeconomic policy, including income policy and exchange rate management.

Finally, the Polish Government maintains the view that sound fiscal and monetary policies would decisively facilitate the establishment of financial discipline at the sector as well as the firm level. In fact, sound financial policies will entail the elimination of the numerous causes of widespread distortions induced by the budget and credit policy.

The achievement of an approximate balance in the general government accounts is one of the pillars of the overall strategy. The projected reduction of the imbalance between revenue and expenditure in the Core General Government budget (8 percent of GDP) is one of the many manifestations of the front-loaded approach chosen. Moreover, the significant change in the expenditure structure shows the clear priority that the authorities have given to eliminating fiscal distortion at the sector and firm level--subsidy reduction alone is equal to 8 percent of GDP--and to creating a social safety net to maintain political and social support for the program.

My Polish authorities realize that a temporary rise in unemployment should be tolerated. However, unemployment benefits together with intense retraining activity would both help minimize the transition to greater labor mobility and efficiency. They also believe that it is imperative to shelter the neediest members of the society from the temporary negative effects of the adjustment program. To this end, pension benefits and family allowances would be periodically re-evaluated and a Plan of Action would be prepared to provide benefits to appropriately targeted components of the society. My Polish authorities are seeking both technical assistance and international financial support for the speedy and cost-effective implementation of these wide-ranging social policies.

The projected increase of budgetary revenues is essentially concentrated in income tax and dividends, with minor change in the overall tax structure. The Polish authorities are, however, planning to introduce major reforms in the taxation system in 1991-92 to reduce the heavy reliance on taxation of the enterprise sector and to achieve more equitable burden sharing of the budget financing.

In the rapid transition toward the establishment of financial discipline, three main objectives are assigned to monetary policy: create a barrier to resist demand pressures; restore confidence in the zloty as a store of value and means of exchange, thus reversing the dollarization of the economy; and establish a system in which interest rates are the principal means through which efficient credit allocation is achieved.

Important institutional changes would be required to fully implement this new modus operandi of the financial sector. In this context, the full independence of the National Bank of Poland (NBP) has been established. During 1990, the Government will not borrow, either directly or indirectly, from the NBP. From 1991, the NBP will no longer be required to submit to Parliament a quantitative annual credit plan, and will be formally charged with the responsibility for achieving and maintaining the stability of the national currency. A number of relevant operational changes are also required to implement credit policy during the program period. The Polish monetary authorities have decided to shift to indirect monetary and credit control and to induce a new structure of positive real interest rates.

By inducing a new interest rate structure, the Polish monetary authorities intend to swiftly reverse the dollarization process of the economy which is inconsistent with its monetary sovereignty, to sustain an orderly development of the exchange rate market and to remove obstacles to an efficient allocation of the country's financial resources. Consequently, interest rates would be modified periodically in light of all relevant indicators.

The Polish authorities are aware that much remains to be done in order to implement a monetary and credit policy fully based on indirect instruments of monetary control. They therefore warmly thank all central banks that have generously and promptly offered technical assistance, under the coordination of the Fund, in order to facilitate the timely implementation of the new market-oriented money and credit policy.

The development of disruptive inflation after the dismantling of price control, has been the unfortunate feature of previous liberalization efforts. In this respect, the main thrust of the program is that the inflationary bias of liberalization policies may be contained and rapidly dampened by restrictive macroeconomic policies. In the case of Poland, orthodox deflationary policies will need to be accompanied by a strict tax-based incomes policy and, after an initial devaluation of the zloty, by the stabilization of the exchange rate.

In view of the far-reaching beneficial effects of a flexible price system capable of signaling relative scarcity, fostering efficient resource allocation, and giving incentives to the establishment of effective competition, the Polish Government has decided to eliminate most of the remaining restrictions both at the producing and consumer levels. Major adjustments have taken place in the energy sector in view of the prospective effect on the energy/GNP ratio and on the balance of payments.

A courageous and drastic tax-based incomes policy and the stabilization of the exchange rate, after the initial depreciation envisaged in the program, are intended to help contain the immediate inflationary bias of price liberalization and, more important, to sharply and rapidly curb it at an early stage. In particular, nominal wages would be allowed to increase by an amount drastically below inflation. Taxes on any excess of the wage increase above the permissible amount would be levied on enterprises at rates ranging from 200 percent to 500 percent. No exception whatsoever will be allowed.

This decision, which will cause hardship for workers, has not been taken without hesitation. Political support for this policy has grown over time. After careful consideration of the negative effects of alternative solutions, it is now widely felt that the chosen approach is the only valid option. However, to take into account the Government's concern for the intensity of the real income loss, the indexation coefficient will be reviewed on the occasion of the first review of the program. In addition, the Polish Government would shift, over the medium term, to a more flexible wage settlement system to allow a more market-oriented determination of wage relativities and growth.

In the context of the introduction of the convertibility of the zloty, the exchange rate has been significantly devalued. After the initial unavoidable inflationary impulse, however, the nominal exchange rate fixity envisaged in the program in the first three months of 1990 will act as a powerful anchor against further price increases, reinforcing the effects of the strict wage policy. The exchange rate policy will continue to be used as an anchor against inflation in the subsequent months.

The stability of the real exchange rate in terms of labor cost will prevent, in fact, the full pass-through of the inflationary impulse that would stem from possible nominal exchange rate adjustments after the initial period of nominal exchange rate fixity.

The Polish authorities are well aware of the danger of the exchange rate-price spiral and are fully committed to prudent management of their currency.

The program also contains a number of measures aimed at fostering systemic changes and ultimately enhancing the supply response of the country. The Polish authorities have committed themselves to a comprehensive privatization program, to establishing a capital market, modernizing the banking sector, strengthening banking supervision, and enacting new stringent antimonopoly legislation. These initiatives are necessary to complement the stabilization and liberalization measures. The Government, aware of the need to quickly enhance the supply response of the economy, has also envisaged the active involvement of the World Bank in its stabilization program. World Bank financing will contribute to help the balance of payments of Poland in the short term, while promoting the efficiency and productivity of the Polish economy in the longer term. Two loans will be soon discussed for approval by the Executive Board of the Bank. A $260 million loan is expected to finance projects in the industrial sector, while a $100 million loan will provide funds for projects related to export-oriented agroindustrial enterprises. Both groups of projects aim at improving the convertible currency trade balance of Poland in the short term by increasing the volume, quality, and value added of exports to convertible currency markets and to support the development of an active private sector.

Market and marketing prospects for all the products involved appear to be good. Most of the increased output that will be obtained is in products which Poland is already exporting, thus minimizing the risk normally associated with the entry into new markets.

In 1990, output is expected to fall as a result of the restrictive macroeconomic policies envisaged in the program and the short-term impact of restructuring. Nonetheless, the current balance is anticipated to worsen by about $1 billion, mainly because of an increase in imports well above the projected limited increase of exports.

There is no inconsistency between the diverging pattern of production and imports. Imports are tentatively estimated to outpace the output trend, mainly as an effect of the liberalization of the trade system. On the other hand, the positive supply response to changes in the relative forces and to supply-side measures that the Polish Government is implementing might be limited and might occur with a lag, after a temporary fall in domestic production.

The widening of the current account imbalance, given the level of debt service falling due and arrears outstanding, as well as the needed gross international reserve accumulation, implies a potential financing gap of $10 billion. In closing this gap, the staff assumes that Poland will succeed in rescheduling a large proportion of debt obligations falling due during the program period, as well as the arrears outstanding at the end of 1989.

In the light of the need to strengthen the external position of Poland and of the great uncertainty surrounding the development of the trade balance, it is the Polish authorities' intention to seek full relief of debt service falling due in 1990. It is also their intention to establish the principle of comparability of treatment among the different groups of creditors. This may imply a larger debt-service reduction than implied in the staff paper.

This possibility has been discussed in a preliminary fashion with the banks. Pending a final conclusion on this matter, the Polish authorities have suspended the payment of medium- and long-term debt. The commercial banks have constructively agreed to resume discussions as early as possible to find a fair solution.

The matter of the amount and of the terms and conditions of debt relief assumes paramount importance in a medium-term perspective. The scenarios prepared by the staff give clear indications that new money and rescheduling alone would not allow balance of payments viability over the next few years, unless unacceptable and unduly prolonged output and import compression is imposed on Poland. A viable external position would be possible only if substantial debt-service and/or interest-service reduction is allowed to take place.

The Polish authorities are confident that friendly official creditors, which hold a large share of Polish external debt, commercial banks, and some other creditors understand the scope and implications of the unique case of Poland, and that up-front international support, through substantial debt relief, should inevitably have to play a crucial role in this unprecedented adjustment effort of Poland.

In conclusion, the program before us today represents an important breakthrough aimed at transforming significantly the Polish economy. It is comprehensive, strong and, I dare say, unique for the historic challenge that it represents and the changes that it intends to bring about.

The Government, being concerned about the hardship that the adjustment involved will certainly cause the population, has adopted a radical approach--rather than a gradual one--which will limit to a minimum the period of transition necessary to set up a market system. This radical shift in policy, which certainly involves risks, is courageous. It has been made possible because of the vast popular endorsement of the Government, and the anticipated, crucial international financial support. Of this support, the stand-by arrangement with the Fund is the keystone.

Extending his remarks, Mr. Filosa noted that the Italian Ministry of Treasury had given permission to the Ufficio Italiano Cambi to arrange for the disbursement of the $100 million that was Italy's share of the Stabilization Fund for Poland. That participation would be in the form of a renewable loan at the concessional rate of 2 percent. The National Bank of Poland and the Government of Poland had been informed of the availability of the money.

Mr. Dawson made the following statement:

We are very pleased to consider Poland's request for a stand-by arrangement in support of its economic reform program. This is, indeed, an historic endeavor. Poland's attempt to shift from a centrally directed, command economy to a market-oriented system is unprecedented. And its program for accomplishing this is radical--both in its scope of reform and speed of adjustment. We admire the Poles for their vision and resolve, and we commend the Fund staff and management for their dedicated efforts to help develop the economic framework for this remarkable undertaking.

As the staff report and Mr. Filosa's statement indicate, Poland is setting out on a lengthy and difficult journey for which there is no pre-established road map. Nevertheless, it is critically important to Poland, as well as to its neighbors and friends, that Poland reach its destination. While there is a clear role for external assistance, the success of Poland's reform program is mainly in the hands of the Polish authorities and the Polish people. In this context, the strong measures taken in the last quarter of 1989 to control wages, reduce subsidies, free prices, tighten credit, and adjust the exchange rate are very encouraging. They have signalled the authorities' strong commitment to change and have helped to build the momentum needed to make the program succeed.

We strongly support the 1990 program. In our view, the focus on curbing inflation dramatically, while beginning an immediate transformation of the economic system, is appropriate. And the strategy of using the exchange rate and wages as anchors against inflation, supported by classical fiscal and monetary restraint, is coherent. We recognize that the intended scope and speed of reform, and the lack of historical precedents to follow, make the program particularly risky. However, given the magnitude of the problems facing Poland, we agree that a more gradual approach would put the reform process in still greater jeopardy.

In the first quarter, the program appears potentially vulnerable in several respects: in maintaining a fixed exchange rate within the framework of limited convertibility; in limiting wage increases in the face of high inflation; in controlling credit to public sector enterprises, despite their financial difficulties; and in responding quickly and appropriately to any market imbalances for key commodities, as seems to be the case for wheat. Clearly, the program's success in the first quarter, and beyond, will depend upon the authorities' firm adherence to their chosen policy course. It will also require particular vigilance on the part of the Poles and the Fund to detect and address emerging problems quickly, before they undermine the program. As the potential wheat shortage suggests, the leads and lags of the adjustment process can be expected to create problems; the challenge will be to solve them in a politically acceptable way, without imbedding existing price and other distortions in the economy.

As for Poland's external position, it is clear that substantial amounts of international assistance, including debt relief, will be required to close the financing gap. Indeed, the international community has already demonstrated its strong desire to help Poland through this difficult period of adjustment. Cooperation from creditors, however, will be predicated on Poland's adherence to the principle of comparable treatment. In this connection, we welcome the indication in the staff report that the Polish authorities intend to conduct their discussions with creditor groups on this basis. In addition, we understand that Poland intends to seek a full rescheduling of debt service and arrears. On the other hand, we expect that some creditor governments would like to see significant repayments within the limits of the foreign exchange which might be available to the Poles, based on the Fund's targets and projections. As these projections are highly tentative, we believe that a full rescheduling would be desirable to increase the prospects for the program's success.

Another important issue concerning Poland's external debt relates to the accumulation of arrears to the commercial banks. In view of Poland's strong adjustment effort, the importance of Fund support, and the fact that discussions with commercial banks are underway, we believe that it is important to go ahead with the stand-by arrangement. However, we will need to keep this situation under review, and return to the matter at the time of the first review, if it has not yet been resolved.

In conclusion, we strongly support this ambitious and far-reaching program. We wish the Polish authorities success and look forward to assessing their progress at the first review.

Mr. Grosche made the following statement:

We commend the Polish authorities for their courage in implementing swiftly a radical and ambitious program of macroeconomic stabilization and structural reform. They are heavily burdened with the dismal results of an ill-conceived economic system and half-hearted reform attempts in the past. The road to an efficient, market-based economy is thorny and calls for additional hardships for the Polish people in the period of transition.

The restructuring of the Polish economy is a challenge for not only the authorities but also this institution. Stabilizing an economy with run-away inflation is already a huge task in itself; attempting in addition the transformation of a whole economic system on a scale that has not been attempted before poses great risks, indeed. But after evaluating these risks against alternative courses of action, the risks seem fairly reasonable and acceptable. Considering, however, the many problems that lie ahead, I was extremely happy to note the constructive spirit of collaboration that has been established between the Fund staff and the Polish authorities. This spirit should help in reacting quickly to the many unforeseen events that have to be expected when starting into such uncharted waters.

The program attempts first of all to break the inflation. I agree with the staff and the authorities that free but stable prices are crucial for the success of the whole program. Tight fiscal and monetary policies and substantial cuts in income, although painful, are unavoidable. I welcome the measures the authorities have already taken, in particular their front-loading in order to limit the costs and the duration of the disinflation process as much as possible. I also fully agree with the authorities that gradualism does not work. Given the substantial risks, however, I endorse the staff's view that developments should be monitored even more closely than usual.

The first three months will be particularly crucial. I hope that, by the end of the first quarter, both real wages and the anchor of stable exchange rates will have produced so much stability that the markets do not expect a return to the inflationary spiral driven by nominal wage increases and continual depreciations. I was glad to note from Mr. Filosa's statement that tight macroeconomic conditions will be maintained, so that exchange rate policy can be used as an anchor against inflation in the subsequent months, too.

The necessary social consensus for a restrictive incomes policy can be maintained only if the neediest are sheltered from its harsh effects, if an unemployment benefits scheme is introduced, and, most important, if there is hope for an overall improvement in the supply conditions justifying the sacrifices. I am glad to note that a so-called "Plan of Action" to provide benefits to the neediest is being prepared.

For the macroeconomic stabilization to bear fruit in the form of a quick supply response, a microeconomic environment has to be created in which individuals can compete with each other in open markets. Institutional reforms are of the essence. I encourage the authorities to press ahead with systemic changes. Partial liberalization and step-by-step implementation of market mechanisms would only worsen the shortcomings of a still overregulated economy. Even some front-loading of institutional measures might be called for.

I am quite afraid that the freeing up of prices in a still monopolistic market structure could turn out to be counterproductive. Monopolistic profit maximizing behavior always leads to higher prices without any incentive to increase supply. I am not advocating the maintenance of administered price controls except for a few limited items. This would only invite state and other enterprises not to feel accountable for their financial position and would put pressure on the budget to maintain subsidies. I would stress the need to bring forth the institutional framework that will allow the unfolding of a market economy as quickly as possible. This includes a broad range of measures. Most importantly, the question of property rights must be clarified, admittedly a difficult question in a former communist governed country. But the safeguarding of private property rights is a conditio sine qua non for a dynamic process of markets and competition. The envisaged privatization of state enterprises should be implemented as soon as possible. Monopolistic structures have to be split up. But competition has not only to be established, but also safeguarded against its self-defeating tendencies. This means antitrust laws and other measures. Remaining barriers to entry to and exit from markets have to be removed. All this certainly requires a completely different legal framework.

But without a competitive environment the supply response of the economy will be disappointing--even with a radical macroeconomic retrenchment policy. Institutional reforms are also necessary in the banking system, with a view to efficiently channeling private savings into productive investments. I wholeheartedly welcome the decision to establish full independence of the National Bank of Poland. The decision of the Government not to borrow from the National Bank during 1990 should become the rule for the future and should be protected by law, as well as the objective of making the zloty a stable currency.

As has been proven amply over the past two months, the international community stands ready to support Poland in its bold and radical shift toward a stable, market-oriented economy. In addition, we expect the Paris Club to reschedule overdue obligations and forthcoming obligations to creditors, and on very generous terms. As we expect the commercial banks to respond similarly, Poland's arrears can for the time being be tolerated. Some of them may go beyond what the staff had assumed in its balance of payments projections. But given the many uncertainties surrounding these projections, I tend not to be overly concerned about a certain--what could be called--"overfinancing" of Poland's balance of payments.

Considering, however, efforts undertaken by all creditors and donors, I wonder whether access to the Fund's resources in this first year of probably prolonged involvement of the Fund in Poland is not somewhat on the high side, especially as, unfortunately, the Fund's money is currently rather expensive. While I can go along with the suggested access, I would urge management and the authorities to ponder carefully access under future arrangements.

In sum, Poland faces a historic challenge. But the country's response is bold, swift, and imaginative. The program before us is not perfect. It entails many risks, which is probably unavoidable in the difficult circumstances. But it is clearly a promising step on the road to a market economy. Poland deserves the Fund's support for such a program. Therefore, I support the proposed decision.

Mr. Yamazaki made the following statement:

We welcome the request for a stand-by arrangement by Poland not only because on previous occasions this chair encouraged the authorities to embark on a program supported by the Fund, but also because the economic reform in Poland will no doubt have a significantly positive impact on its neighboring member and nonmember countries. Before addressing the specific issues, we would like to commend the staff for its strenuous efforts to help the authorities formulate the program under an enormous time constraint. We also appreciate very much the Managing Director's personal involvement. We found the thrust of the staff paper appropriate and have no difficulties in supporting the proposed decisions. Nonetheless, we would like to make some comments on the areas to which we attach particular importance.

It is clear that the authorities are now facing short-term difficulties, such as hyperinflation, as well as long-term challenges, namely, the need to implement market-oriented economic reforms. Since these short-term difficulties and long-term challenges are closely interlinked, the program should aim at both areas simultaneously and comprehensively. While the authorities are to be credited with the progress made in previous years, the topical and gradual approach that the authorities adopted up to 1989 dismantled the deficiency of the economy and was the focus of the previous Article IV consultations. Thus, the courageous adjustment efforts initiated by the new administration are especially commendable. The program before us today is an ambitious one and, as the staff notes, involves some risk. Moreover, the difficulties and challenges that the authorities have to tackle will entail substantial sacrifice. However, we believe that persistence with the program will pave the way for the future growth of Poland.

The lax financial policy combined with the deficient economic system have clearly been the driving force behind the rampant inflation. Thus, fiscal and credit policy should assume the main responsibility for containing inflation. As the staff points out, output and employment are the most uncertain areas in this initial stage of the program. However, it should be emphasized that any slippage in wage and financial policies in response to unfavorable developments in output and employment would only rekindle the wage-inflation spiral and undermine the credibility of the whole program.

We support the strategy of focusing on the exchange rate and wages as two nominal anchors. However, since the credibility of economic management has not been fully established, some skepticism may arise. The exchange market would be most susceptible to such skepticism; commitment to and follow-through on the program would do much to negate such skepticism. While the Stabilization Fund will clearly buttress exchange stability, we would like to emphasize that the stabilization fund should never be regarded as a substitute for appropriate tightening of financial policies. In this context, we would welcome the staff's elaboration on the price-taking mechanism of the kantor market. We are particularly interested in whether kantories are speculators or commission earners, and how the kantor market rate would deviate from the official exchange rate.

The authorities have a long way to go to transform the economy. Systemic changes on an unprecedented scale are called for. Radical price adjustments demonstrate the authorities' commitment; however, we encourage the authorities to liberalize prices even more. In particular, energy prices should be adjusted further.

We welcome the substantial liberalization of the exchange and trade system. Nevertheless, in our view, much remains to be done. In particular, the authorities should make further efforts at liberalization aimed at the unification of the exchange market. In this connection, the staff should comment on the convertibility of the zloty and clarify what kind of convertibility the authorities have in mind.

The balance of payments situation vis-à-vis the CMEA area may give rise to some misgivings on the part of creditors in the convertible area. While we welcome the projected reduction of the current account surplus in 1990, we encourage the authorities to continue to review this issue.

Finally, I wish to comment on the financing gap and the balance of payments projection. Given the importance of the Fund's support for the authorities' adjustment efforts, we support outright approval of the arrangement. At the same time, we urge the authorities to expedite their negotiations with the commercial banks.

The medium-term scenario prepared by the staff raises important and difficult questions. In order to sustain growth, Poland will have to rely on continued capital inflows in the years to come. However, the heavy debt burden overshadows the prospects for regaining external viability and may be taken as contradicting the need for continued capital inflows. Nonetheless, we are aware of the uncertainty inherent in the medium-term projections; uncertainty will be particularly great in the early stages of the program. We also see a possibility that nondebt-creating capital inflows might play a role. Thus, we would like to discuss this topic at a later date, based on the performance under the program.

Mr. Cassell made the following statement:

The Polish authorities have embarked upon a far-reaching program, designed simultaneously to stabilize the economy and to transform it rapidly into one based on market forces, price incentives, and private ownership. An economic revolution of this scope and pace has never before been attempted.

Faced with this unprecedented challenge, the new Government has rightly turned its back on gradualism, and has determined on a path of swift, radical, and all-embracing reform. The program before us reflects the authorities' vision and courage. It is a historic program for the Fund, and I support it wholeheartedly.

Nevertheless, despite the obvious commitment of the authorities to the task they have set themselves, and despite the widespread support they currently enjoy both at home and abroad, it is clear that--in the words of the staff--"the program is not without significant risks."

I will comment on three absolutely crucial questions: is the program correctly sequenced; is it sustainable; and can it succeed where previous market-oriented reform programs have failed--can it reduce, indeed drastically reduce, inflationary pressure without the help of the direct controls of central planning?

These issues are of course closely interrelated. The sustainability of the program will depend critically upon the authorities' success in curbing inflation. If the inflationary momentum is not quickly and decisively reversed, the credibility of the authorities' entire strategy will be severely dented.

This leads directly to the question of sequencing--how can inflation best be tackled in the context of market-oriented reform? Should structural and institutional changes be implemented prior to a tightening of macroeconomic policy, or should the initial priority be to effect a major financial squeeze? Should direct controls over prices be retained until underlying demand and supply conditions are brought into balance, or would such controls merely inhibit the restoration of domestic equilibrium and exacerbate underlying inflationary pressure?

The authorities have tried to finesse the sequencing issue by opting for a "big bang" approach. They have chosen to implement bold structural reform alongside a dramatic tightening of fiscal, monetary, and incomes policies. And this comprehensive policy package has been accompanied--up front--by the virtual elimination of price controls and a far-reaching reform of the exchange and trade system.

Nonetheless, given the administrative and legislative constraints facing the authorities, and the sheer technical and legal complexity of the program, it is inevitable that many of the key institutional and structural measures built into it will take time to put in place--that they will follow, not accompany, the sharp macroeconomic squeeze introduced at the start of the year. To take just one example, despite the authorities' commitment to privatization, and despite the importance this will have for the establishment of financial discipline and the creation of an appropriate incentive structure within the economy, the reality is that production will continue to be dominated by the state enterprise sector for some considerable time to come.

These--unavoidable--implementation lags bring with them a significant threat to the sustainability of the program. Most obviously, in the absence of early structural and institutional reform, how quickly will economic agents begin to respond to the introduction of price incentives? In the absence of more rapid enterprise reform, can the indirect levers of macroeconomic policy bite and begin to reverse the inflationary momentum?

What little evidence we have is, inevitably, rather mixed. On the one hand, the muted response of the agricultural sector to the recent liberalization of food prices suggests that the authorities would be ill-advised to count on a rapid supply response in the short term. On the other hand, the impressive growth in the private sector over the past year indicates that the economy has significant untapped potential.

The political sustainability of the program will depend substantially on how the state enterprises respond to the current macroeconomic squeeze and on the private sector's ability to pick up any slack that emerges. The program envisages a 70 percent cut in the real value of subsidies, together with a sharp reduction in fiscal exemptions, and a substantial increase in the cost of credit. Against this, most enterprises will be free for the first time to set prices at market levels; if the program is implemented as planned, real wage costs will fall significantly; and the availability of credit to the nongovernment sector will be considerably enhanced.

The net impact of these various factors is impossible to predict. However, it is clearly vital--both politically and economically--that carefully targeted safety nets are put in place as soon as possible.

The third major uncertainty--equally crucial for sustainability--is whether the program will deliver on inflation. The authorities have implemented a sharp tightening of macroeconomic policy while buttressing the fight against inflation with two nominal anchors designed to transform expectations and cut through the vicious wage-price spiral of the last two years. Implementation of this liquidity crunch has required enormous courage on the part of the authorities, and while it is not yet clear whether the measures already taken will prove sufficient, the early indications are quite promising. The price level appears to have jumped by rather more than expected at the beginning of January, but since then prices have begun to stabilize. The new exchange rate system seems to be operating smoothly, and despite sporadic unrest, the indications are that so far the authorities' austere wage policy is holding firm.

These are all welcome signs; but there is clearly no room for complacency. If the authorities' objectives are to be realized, they must implement rigorously the policies currently in place. Wage demands will need to be firmly resisted and credit ceilings strictly enforced--there can be no return to the mistakes of the past, when financial discipline was undermined by a negotiable tax policy, accommodating credit flows, and automatic subsidies.

I agree with the staff that the fact that risks surround the authorities' program does not mean that the approach they have taken is misconceived. On the contrary, the radical and comprehensive program before us offers Poland the best chance for the future. But a program with risks must be monitored vigilantly. It must also be supported fully, and on comparable terms, by the international financial community as a whole--Western governments, the country's commercial banks, and other official creditors. The Fund, too, will play a critical role in the months ahead, monitoring the program, coordinating technical assistance, and advising the authorities on any additional measures that become necessary.

Mr. Grosche referred to the possibility of overfinancing. Of course, the outlook is very uncertain. If there is any overfinancing, the excess funds should be placed to reserves, given the considerable uncertainties and risks to which I have already referred.

The extraordinary determination and commitment of the authorities, the expertise of the staff, and the active and timely support of the international community provide the best possible assurance that this path-breaking program will meet with success. I fully support the proposed decision.

Mr. Feldman made the following statement:

I heartily welcome the consideration by the Board of Poland's unique and historic case and fully support the proposed decisions. Poland has begun to implement a comprehensive program of stabilization and economic reform which is moving the country away from previous inefficient structures of administrative control and price repression and toward full market mechanisms. To my knowledge, there are no precedents for such a dramatic shift in policies in a country that intends to embark on a Fund-supported program; this fact makes the case both a fascinating but also a risky one that will necessitate careful monitoring of developments and a readiness to adopt measures as the situation requires.

The extremely difficult circumstances facing Poland during most of 1989 are well described in the staff's documents as well as in Mr. Filosa's statement, and there is no need to repeat them now. I wish to underline a few peculiarities of this case that are important in the design and implementation of the program, and particularly its stabilization component. At the inception of the program, Poland was exhibiting evidence that it faced many, if not most, of the problems that are usually present under conditions of very high inflation or hyperinflation, namely, accelerating price increases, demonetization, and recession.

However, and uncharacteristically, during the first nine months of 1989 Poland also experienced increases in the level of real wages and increases in state expenditures--associated with higher wages and subsidies--equivalent to 2 percentage points of GDP. These developments are rather unusual for a country experiencing a strong acceleration of inflation.

Another peculiarity appears on the external front, where, amidst the recent political and economic convulsions, the country had to face a critical financial constraint and the authorities chose to fall into arrears first with official creditors; until very recently, Poland remained current with its commercial bank creditors. This is relevant for the issue of comparability of treatment of creditors.

The policy approach adopted by the Polish authorities is undoubtedly correct. Like the staff, I believe that the program is coherent and feasible, and has set the right priorities. As in similar cases, I remain concerned about the pace of some reforms, given the absolute need to stabilize prices as a precondition for success. The situation calls for a shock treatment, entailing rapid and radical solutions to the critical condition of the economy; previous experiences with partial and gradual approaches have been unsatisfactory, and the authorities understand that the difficult and painful period of adjustment should be as short as possible. Furthermore, the authorities contend that widespread political support from within and outside the country is currently very strong and should be capitalized upon in order to implement difficult policy actions and to receive the much-needed external financial support.

Now, the program aims both at achieving a rapid stabilization and at transforming Poland into an efficient, market-oriented economy. Obviously both objectives are closely interrelated. I agree with the staff appraisal that, unless inflation is curbed quickly, the allocative role assigned to relative prices could be overburdened, thereby reducing the effectiveness of market-oriented reforms. At the same time, without a deep transformation of economic structures, financial and monetary discipline will not induce the required response on the supply side.

As Mr. Filosa pointed out, the period of adjustment will be difficult and will cause hardship for the population. This hardship should be absorbed by the population, which is prepared and motivated for doing so and is showing signs of strongly supporting the program. The hardship is unavoidable, but the intensity of the hardship is crucial for the survival and success of the program. The worst-case scenario would be the abandonment of the program because the "level" of hardship is not tolerated--after all, what is at stake here is the future of the country.

This brings me to the design of the stabilization program. I will comment first on the use of tax-based incomes policies and the exchange rate as anchors against inflation. Nominal wages are in fact an imperfect anchor--a drag rather than an anchor--as prices, to which wages are linked, will not be frozen and are expected to increase substantially in the early stages of the program. I wonder whether the staff can confirm that, after the rapid growth during the first part of January, the rate of inflation has now receded substantially. The "real" anchor on prices is the projected fall in real wages through its impact on effective demand. In this respect, the Polish case differs from other stabilization attempts, where wages in real terms--or, to be more precise--the purchasing power of wages, increased after the initial realignment of relative prices. This increase acted as a cushion to recession in those other cases. In the case of Poland, in contrast, we should recognize that real wages have been increasing before the attempt to stabilize, and that their level was too high at the inception of the program. I wonder whether it would have been more tolerable to generate a once-and-for-all decline in real wages at the beginning of the program, or whether, as it was concluded, real wages will keep falling strongly as long as prices are not stabilized.

As an initial price freeze has been ruled out--and there are good reasons and widespread negative experience leading to such a decision--relative prices might remain in a state of continuous flux during the process of economic liberalization. It is in this area where the program shows itself in all its complexity. Simultaneous stabilization and market reform may require conflicting policies in the short run. A short period of price freeze, in a context of strong fiscal and credit discipline, might have helped to achieve stabilization very quickly. On the other hand, the difficulties in making a way out of a price freeze are well known; also, in a context of a highly distorted set of relative prices like the one prevailing in Poland at the inception of the program, a price freeze could have been very counterproductive for a program intending to introduce rationality into resource allocation. Hence, the decision to dismantle price controls has already been taken, and the rapid deceleration of inflation, which will rely to a large extent on the wage and exchange rate anchors, will also crucially depend on the existence of downward flexibility in nominal prices. The role of monetary and fiscal policies as a barrier to resist demand pressures will be essential in this respect. But excessive price rigidity may induce further corrections in output leading to higher unemployment.

We perceive that the projected fall in real wages, combined with tight demand policies and the initial unavoidable disruptions derived from market liberalization in a context of price rigidities, may result in a greater than projected decline in output and employment. In this context, we share the staff's concern about the risk that the initial consequences for output and employment might be worse than anticipated and put the program under strain.

In other words, if recession turns into hyperrecession, the problems facing the authorities may become intractable.

To avoid hyperrecession, or to cushion its undesirable effects, the creation of safety nets and the assurance of timely and adequate external assistance become absolutely crucial safeguards. In particular, unemployment benefits and retraining programs will alleviate the pressures from those who are temporarily without jobs and could also greatly improve the quality of the labor supply. Unemployment is a very sensitive issue in Poland, for several reasons: first, because it has remained negligible since the early 1980s, and, in fact, enterprises have complained of labor shortages; and, second, because the well-known concept of a "reserve army" cannot be eradicated overnight and perhaps has not been eradicated yet. One may presume that the acknowledgment by the Polish population and authorities that some unemployment is inherent to the functioning of a market-oriented economy will take some time; hence the critical importance of safety nets and of external finance to cushion the initial impact of stabilization and reform.

The exchange rate will also be utilized as an anchor during the first three months of the program; subsequently, it will be adjusted pari passu with nominal wages. Given the rule adopted for wage correction, this may entail some exchange rate appreciation, although this risk will obviously tend to disappear as Poland reaches price stability. If this rule for adjusting the exchange rate has to operate under a still relatively high rate of inflation, then the maintenance of Poland's external competitiveness should be reassessed by the Fund and the Polish authorities. Obviously, the magnitude and generous conditions of the external support will be, as is evident in other similar cases, of crucial help for the consolidation of the exchange rate policy.

With respect to fiscal policy, fortunately, and in contrast to other middle-income heavily indebted countries, Poland does not have a long deep-rooted tradition of running large fiscal imbalances. The avoidance of hyperrecession will also be important to avoid deviating significantly from the projected increase in budget revenues. I fully agree with the staff and Mr. Filosa on the objectives assigned to monetary policy. I only hope that the program will work successfully as designed, and that there will be no need for further intensification of financial policies, given the recessive bias of the stabilization program already in place.

Poland started to introduce market reforms before this program, but in a half-hearted way, with hesitation and lacking full conviction and political support; this situation has changed dramatically in recent months, and now the Polish authorities aretackling market inefficiencies with great courage and determination. But, in my view, the question of pace is crucial. Mr. Filosa has underlined in his statement the failures of the 1980s, derived from the introduction of partial reforms; he reminds us of the crucial distinction between partial and global reforms, which are different from gradual and drastic reforms. I believe that, while gradualism is absolutely out of the question and would lead to failure of the stabilization policies, the pace of market and institutional reforms should be permanently reassessed by the Fund and Poland. There is no doubt about the need for a shock treatment to stabilize the Polish economy; but in the structural sphere what is important is to avoid partial reforms--which led to failures in the past--and to envisage reforms that are as wide and comprehensive as possible at a speed dictated by political and short-run economic circumstances. In our view, the pace of the structural reform process should be at the center of a fluid and open-minded discussion between the Fund and Poland. A great deal of caution should be exercised in implementing these reforms and in evaluating additional economic measures. An overly cautious, slow implementation of the systemic changes could render the reform efforts fruitless. Conversely, hasty implementation could result in excessive disruption and a most unfortunate lost opportunity for Poland and its people.

In the external sector, it is clear that reliance on conventional financing is the most expeditious approach to meeting the financing requirements for 1990. In this respect, a rapid and adequate response from all creditors immediately after Fund approval of the stand-by arrangement is essential to close the large financing gap facing Poland in 1990. For the future external viability of Poland, however, I concur with the staff and the Polish authorities on the need for debt and debt-service reduction. The fact that a large proportion of Poland's debt is to official creditors and that Poland is not "Toronto eligible," will make this case a very difficult and challenging one that will require exceptional treatment.

We wish the Polish authorities every success in this historic enterprise, because the Polish people will benefit from this success, and because this success may become the extraordinary example that other countries facing similar, or perhaps less serious, situations than Poland need to finally proceed with their long overdue adjustment and reforms.

Mr. Cirelli made the following statement:

Today's discussion has an exceptional character. Indeed, the program before us is intended to contribute, in a short period, to regaining control over the disrupted evolution of positive macroeconomic developments in Poland as well as to enable Poland to build a market-oriented economy. The challenge is immense. The transition from a centrally planned economy to a market-oriented one is a difficult area where, as the staff notes, there is virtually no theory for guidance. Certainly, Poland needs far-reaching reforms in all economic sectors. Furthermore, success will depend to a great extent on the authorities' ability to move simultaneously in all areas of the economy, which are closely interrelated, and, moreover, this far-reaching movement has to take place in an economy where there are no market mechanisms and the structure of relative prices is completely distorted both by hyperinflation and by the functioning of the system itself.

Against this background, the authorities have adopted a radical "one go" approach. The question of the pace of reforms to be undertaken is certainly not an easy one to answer. Given the economic situation of Poland, the radical shift in policy chosen by the authorities is courageous, as Mr. Filosa rightly pointed out in his statement. This shock therapy is aimed at minimizing the period of transition necessary to set up a market system, and the concern about setting bounds on the unavoidable hardship that this adjustment will cause the population is understandable.

Nevertheless, these concerns only reinforce the need for institutional changes that are fully tied to the success of this radical policy shift. Indeed, the comprehensive and strong commitment of the authorities to introduce a new general framework would prove to be efficient and finally ensure the success of the program only if the needed institutional reforms aimed at allowing the authorities to maintain macroeconomic control and stimulate investment and supply are also implemented. The staff report rightly emphasizes this issue.

With respect to the program, the priority given to rapidly stabilizing inflation and restructuring relative prices is most appropriate. The need to urgently dismantle the inflationary spiral is indeed the prerequisite for the program's success. The authorities' intention to fight inflation through exchange rate and incomes policies is adequate, although challenging. The decision to use the exchange rate and wages as nominal anchors is critical to the attempt to stabilize the economy quickly and decisively to break the momentum of inflation. The bold exchange rate policy implemented at the beginning of the year is risky and vulnerable, but we share the view that this fully predictable policy should provide the required anchor for the evolution of nominal values.

I am pleased that this policy has been coupled with the opening up of the exchange and trade systems, thus avoiding adverse effects on the efficiency of foreign trade decisions. The elimination of exchange and trade restrictions is indeed an indispensable complement to price liberalization.

Should pressures be exerted on the exchange rate, the active use of financial policies, and especially interest rate policy, will be needed to prevent losses of reserves. The emphasis in the staff report on this action is fully warranted. In this task, the authorities can also count, as a last resort, on the stabilization fund, which provides important backing to the policy and to which my country has wholeheartedly contributed.

The success of the disinflation policy will also depend heavily on incomes policy and the authorities' ability to resist any request for exemptions or relief from that policy. Indeed, tax-based incomes policies have already been introduced in the past, and with little success. This policy will be all the more successful to the extent that the disinflation process is fast and efficient. We are aware of the policy's consequences; the figures described in the report are impressive. We share the authorities' view that the cost of their policy stance is high. Nevertheless, strict control of wages will be decisive in ensuring the overall success of the program and in breaking inflationary pressures channeled through excess demand. In this context, the measures taken to liberalize prices could complicate the incomes policy objective. These measures are, however, indispensable to create the basis for a market economy and to eliminate the distortions in relative prices, thus ensuring a better allocation of resources.

Given their far-reaching objectives, these measures have to be complemented by stringent fiscal and monetary policies. The program's fiscal policy objectives are ambitious. I encourage the authorities to maintain these objectives; achieving them is of the utmost importance. I feel some concern about the revenue side. The consequences of the changes in the tax structure in 1989, coupled with the expected reduction of output in 1990, could make the realization of the fiscal policy objectives difficult. In this regard, expenditure control will play a critical role, and the ability to reduce the great amount of subsidies is also at stake.

As to credit and monetary policies, the measures taken to raise interest rates to exceed the rate of inflation are welcome. Furthermore, it will be of the utmost importance for the banking system to resist any excess demand by the enterprise sector. Indeed, the planned increase in credit to the nongovernment sector should be enough to accommodate demand. Despite the strong tightening of monetary policy, the program rightly permits a meaningful increase in credit to the non-government sector, which will reinforce the economy's ability to adapt its structure to the new environment.

My last point on the program concerns the external sector. Some uncertainties cloud this area. In 1990, the authorities will be faced for the first time with a trade balance deficit, and the balance of payments projections are not very encouraging. The worsening of the current account deficit and the need to reabsorb the outstanding arrears at the end of 1989 involve considerable amounts. The financing requirements of Poland are substantial, and once again the Polish authorities have to count on the rescheduling of a large proportion of debt obligations falling due during the program period.

Given the weaknesses of Poland's capacity to make payments, my authorities are ready to support the Polish authorities so that they may obtain from the Paris Club an agreement that is compatible with the objectives set out in the program; the agreement should include reimbursement conditions that are well adapted to the medium-term prospects of the Polish economy. My authorities, however, are particularly attached to the principle of comparability of treatment of creditors, and they hope that the other creditors, such as commercial banks and CMEA countries, will also contribute to meeting the external financing needs of Poland.

My authorities believe that the program is well designed and adequate for the restoration of macroeconomic balance. I wish to emphasize the important structural reforms that are needed to transform Poland into a market-oriented economy. Poland has a long history of economic reforms, but, like other Eastern countries, it has not succeeded in reconciling the autonomy of enterprises with central planning. Given this experience, which is well described in various staff papers, I wish to make three remarks.

The first fundamental reform is to give enterprises complete autonomy of decision. In the course of previous reforms, this lack of autonomy has led to the authorities' inability to implement policies of financial restraint and, in particular, to resist demands for wage increases. As it is particularly difficult to reconcile state ownership with autonomous decision making, I welcome the authorities' intention to transform the ownership of enterprises and begin privatization. I wish to encourage them to proceed as fast as possible in this area.

The second step consists of ensuring the competitiveness of enterprises. In this field, prices and trade liberalization, as well as the elimination of subsidies and the maintenance of a realistic interest rate policy, should place enterprises in a situation of competition and make a judgment of their profitability possible.

Third, undoubtedly the immense restructuring of the economy undertaken by the authorities will greatly modify the social structure of the country. The consequences of the overall adjustment and the fundamental changes in economic relationships could be difficult to bear in the transitional period before us. The efforts to provide some shelter to the most vulnerable segments of society against the immediate effects of the adjustment are also a condition for success. Indeed, Poland needs to maintain the consensus of its population that it has reached to date.

We are pleased that many countries have so far demonstrated their willingness to support the tremendous endeavors Poland has embarked upon to address the major imbalances it faces. The group of 24 industrial countries working with the EC has announced a wide range of financial means to participate in the transformation of the Polish economy. Once established, the European Development Bank could play an important and helpful role. A few institutions, however, have assumed the responsibility for giving advice on how to restructure the economy and effectively using the financial assistance provided by the international community. This institution also has undertaken this task. It is true that the program before us involves many risks. But in the circumstance--given the "historic challenge" described by Mr. Filosa--I firmly support management and staff in taking these risks.

I approve the proposed decisions and wish the authorities well in this historic economic revolution.

Mr. Kafka made the following statement:

I fully support Poland's request for a stand-by arrangement. Poland's program is unprecedented and deserves our full enthusiastic support because of the authorities' courage, despite the risks to which the staff has drawn our attention. As Mr. Cirelli implied, meeting risks is the justification for the existence of the Fund.

I also fully agree with the several previous speakers who stressed that, in order to be successful, a program like the Polish one must be formulated in a fashion that makes it politically acceptable. I think that the program for Poland, which was formulated with the help of the staff, meets that condition.

I have some questions about the performance criteria used. First, as I understand it, a "core" general governmental deficit, rather than the usual overall public sector deficit, was chosen as a performance criterion; however, the former is a very crude measure compared with the latter. We note that the program does not directly address deficits in the public enterprise sector; this is a complicated matter, which involves the overall public debt, including enterprise debt, as well as the purpose of any enterprise defined. Second, one of the performance criteria is changes in wages in the five main areas of the socialized sector. But the authorities have called our attention to the fact that Poland's successive stabilization programs based on wage control have not worked well. We can only hope that the wage criterion will continue to function as it has thus far.

We note with satisfaction the substantial price liberalization in the past year, but 10 percent of prices in terms of GDP, including extremely important sectors like energy, are still controlled by the state and are subject to heavy subsidies. I am not quite sure whether the path of liberalization is rapid enough. Despite the success in the first month of the program, I am also not sure whether it will be possible for the monetary authorities to maintain a stable nominal rate of exchange during the next two months without accepting very large losses of foreign reserves which may not be available. To control the foreign exchange market it is necessary to control interest rates on loans, which the Polish central bank may now have to do without an effective money market; that may not be enough.

Regarding external debt, it would be useful to have a breakdown of interest arrears by nationality of official lenders. We note that the authorities support the principle of comparability of treatment among creditors. This is particularly important for one country in our constituency, Brazil, which has had discussions with Poland since 1981 regarding credit arrears. Brazil has been unable to conclude any bilateral agreement with Poland, and has not received any payment from Poland during that period. We are confident that the situation will be regularized.

There are a number of other questions that it would be interesting for me to discuss, but, in view of the extraordinarily comprehensive list of questions mentioned and discussed by Mr. Cassell, in particular, I will take up my questions on a bilateral basis. I am confident that the international community will live up to its responsibilities toward Poland.

Mr. Clark made the following statement:

The program we are considering today is ambitious, extremely challenging, and particularly risky. It aims for no less than a complete transformation of the Polish economy at the same time that it strives to stabilize the macroeconomic environment. However, Poland has no alternative to following this arduous route, and the international community must do all it can to facilitate its success.

We are all, both Poland and this institution, entering uncharted waters, and it is difficult to judge what is the best path to follow. Nonetheless, in our view, the Polish reform package has the required components and maximizes the prospects for success. We agree with the staff that the program has the right priorities and appropriate pace of adjustment, and that it is coherent, comprehensive, and feasible. Therefore, we support the proposed decisions.

The program has three key related objectives: stabilize the macroeconomic environment by substantially reducing inflation and eliminating the price-wage spiral evidenced over the better part of last year; increase the financial discipline of enterprises while expanding private sector activity; and build the institutional framework required to sustain the initial gains and to facilitate the efficient functioning of markets in the longer term. These objectives are difficult enough to achieve individually, and are especially difficult to reach simultaneously. Nonetheless, only by progressing on all three fronts can the program succeed.

I will comment briefly on these three objectives and some of the risks in achieving them. With regard to the stabilization program, the authorities face the problem of rapidly reducing inflation while accommodating changes in relative prices. Only after inflation is brought under control can relative prices play their appropriate role of sending market signals, and only then can enterprises be expected to operate efficiently and effectively.

Given the specific problems facing Poland, the use of the exchange rate and wages as monetary anchors seems appropriate. Establishing and safeguarding the credibility of the first anchor, the exchange rate, is crucial to the success of the stabilization effort. We are aware that determining the appropriate level for the exchange rate is difficult under any conditions, and particularly so in the current situation of Poland. Nonetheless, if the reform plan is to inspire confidence both domestically and abroad, the authorities must be ready to do all that is required to meet their inflation target and defend the exchange rate. Thus far, developments in the foreign currency market are encouraging.

Another critical factor to the achievement of the stabilization objective is the success of the authorities in effecting a substantial decline in real wages. The past unsatisfactory history of wage schemes underscores the need for close monitoring and strict application of the new guidelines, without exceptions. In this context, the decision to include wage developments among the program's performance criteria is entirely appropriate.

Nonetheless, we can foresee some problems with capping the total wage bill of enterprises rather than some measure of the wage bill adjusted for productivity or for the number of employees. The cap on the wage bill could limit the growth of the more dynamic enterprises, which could be expected to seek to expand their labor force to meet growing demand; this would seem to hinder rather than facilitate labor mobility and the ability of enterprises to respond appropriately to market conditions, and it could exacerbate scarcities. We would caution the authorities on the need to monitor this approach carefully and to review its effectiveness early on in the program.

The objectives of increasing the financial discipline of enterprises and expanding the role of the private economy are particularly important not only in ensuring long-term improvements in the economy but also in achieving stabilization. As is noted in the staff paper, there is considerable risk that financial losses, and the decline in employment and output could be significantly greater than are now anticipated. That development could lead to mounting pressure on the authorities to accommodate early mistakes of managers, whose experience with market practices and financial discipline is limited. However, any concessions at this early stage of the program would have substantial adverse implications for government finances, and could imperil the stabilization process and unravel the basis of the program.

To avoid this outcome, we urge the authorities to leave no doubt that there will be no exceptions to the new financial discipline, and that enterprises will have to live within their means. To this end, the authorities should do all they can to increase enterprises' decision-making autonomy, increase managements' accountability, and improve the transparency of enterprises' financial interactions. Technical assistance from the private sector in other countries could also perhaps contribute to helping the transition to a market economy.

The expansion of the private economy in the immediate months ahead may proceed slowly, partly as a result of the difficult financial situation in the country. However, as inflation falls and confidence increases, the growth of the private sector will take its own natural course and there should be no need for fiscal support from the authorities. Rather, the best encouragement for the private sector would be further removal of remaining regulations and red tape. The Government has a role to play in fostering the appropriate environment and building the institutional framework that will encourage entrepreneurship, risk-taking, and a dynamic private sector.

This brings me to the third objective. The building of the institutional framework may appear of lower priority given the problems that the authorities must cope with at present. However, the institutional framework has a vital role to play in transforming Poland into a market economy. Large-scale privatization and investment will proceed only after major reforms of the banking system and the development of financial markets. Moreover, financial markets will facilitate the operation of monetary policy and overall economic management, thereby reducing the need for direct intervention by the Government in the economy. In that regard, we are pleased to note the significant enhancement of the independence of the National Bank of Poland, and its move toward increasing dependence on indirect instruments. We urge the authorities not to lose sight of the importance of fostering an environment conducive to competition and free-market interactions. In our view, this will be achieved only by rapid progress in putting in place appropriate laws and establishing the necessary institutional framework.

Before concluding, I wish to comment briefly on the role of the international community. As many speakers have already noted, Poland has undertaken a far-reaching and extremely challenging reform program. But there is only so much that Poland can achieve on its own. Thus far, the international community has moved quickly in reacting to the needs of Poland by establishing the stabilization fund, by quickly providing assistance from multilateral institutions, by being ready to provide virtually limitless technical assistance, and by planning to establish a European Development Bank. Nonetheless, more will be needed in the medium term. As the Managing Director pointed out in his letter to Governors, Poland will require particularly generous debt restructuring. In our view, commercial banks will have to contribute to this effort and should not expect to continue receiving preferential treatment over Paris Club creditors as they have in the past. However, as more than two thirds of Poland's debt is due to official creditors, some imaginative solutions from them will be required. Official creditors will need to show flexibility and ensure that any rescheduling agreement can be honored by Poland. But more must be done than to defer Poland's debt payment into the future--the international community must stand ready to help Poland grow out of its debt problem by facilitating foreign investment, particularly joint ventures, and by removing trade barriers--tariff and otherwise--to Polish goods.

The challenges facing the authorities are formidable. They must take every opportunity to act quickly and decisively. They cannot afford to lose momentum or the confidence of the Polish people. As is suggested in the paper, the authorities are aware that the rewards of the effort may not be evident in the coming year. However, they must be prepared to persevere if initial indications suggest that the cost of adjustment is higher than initially anticipated. In the medium term, the benefits of continuing with the program will far outweigh temporary relief gained by slowing down the adjustment process.

Mr. Fernández Ordóñez made the following statement:

The lack of precedents and the transcendence of the program we are going to endorse today make this a historic occasion. The consequences of the success of the program surpasses Poland's borders. It is an experiment, and in this sense many countries will profit from it. Moreover, it is the first experiment of its kind. This lack of precedent and the program's singular features make it the center of attention, but also the source of many difficulties: difficulties for the new Polish Government in designing the program; difficulties for the staff in giving advice with less resort to its customary solid experience, guided mainly by the "dismal science" and common sense; and difficulties for this Board, which faces the challenge of taking a decision to provide some of the Fund's scarce resources on the basis of a program that is full of uncertainties.

All this leads us to approach this meeting with a great dose of modesty in judging the quality of the program, and with a great deal of trust in the Polish authorities in justifying our endorsement. We will leave aside what conservative financial instinct would dictate, because, in this case, being conservative might be the most risky behavior.

With respect to the program, the innovative measures do not pose major problems for us. We are more worried about those measures that have been tried in the past--for instance, the proposed wage policy. The same policy failed in the past, and this is a cause for concern. There is no question about either the benefits of a reduction in real wages to improve competitiveness, or especially of the suffocation of any possible emergence of a spiral of wage-price inflation. That is why we support the authorities' policy; but certainly the lack of imagination in this particular policy area will need to be compensated for by a high degree of bravery in policy implementation.

The whole program is very bold and goes further than anyone could have expected. Nevertheless, and in all humility, we think that in some respects the program has stopped short. For instance, we think that it has been a mistake to reintroduce the obligation of exporters to surrender all foreign exchange receipts to the monetary authorities. In doing this, the Polish authorities have lost an important tool with which to test their program, and this step will slow the development of the export sector that is crucial for success in the medium term. We share the view that the "dollarization" of the economy should be avoided. But the best way to encourage people to buy zlotys is not to force them to buy them. Instead, the fundamentals should be changed, and the market should be free to do its work. I urge the authorities to review this restriction as soon as possible and avoid leaving themselves or to future governments the temptation to use exchange rates to expropriate exporters' earnings. Certainly, it might be argued that many developed countries continue to have this type of restriction, but sometimes if you want to run faster than others, you have to run with less dead weight than others. The openness of the exchange market to convert zlotys into foreign exchange reduces the importance of this problem, but the restrictions will slow the process of attracting foreign investment. Given Poland's exceptional geographic situation and the availability of skilled and relatively cheap labor, Poland enjoys many advantages in attracting foreign capital to export-oriented industries, and this should be the center of its industrial policy. This policy should never be based on subsidies, and, in this connection, we welcome the unraveling of the previous tangle of export subsidies; the establishment of unnecessary hindrances should also be avoided.

The new Polish Government has--with the exception mentioned--maintained some adequate policies that were adopted by the previous Government in the field of liberalization of labor and goods markets as well as in the field of foreign investment, but the scope and importance of the new measures are most impressive. We welcome the proposed reduction of the public deficit, and especially the savings achieved through the courageous reduction of subsidies.

We also welcome the importance attached to credit policy and the key role that has been assigned to interest rates. This approach is an example to those who still doubt the crucial functions of interest rates in the short, medium, and long run. The extensive price liberalization is fully appropriate, and we understand the restrictions that have been maintained for items produced by monopoly sectors.

In future discussions, which, we hope, will include the consideration of an extended arrangement with Poland, we will be able to see in detail the changes that have been announced in the economic system. In our view, among all those changes, privatization will be the most crucial. Nevertheless, the rest of the policies announced--the reform of the tax system, the new labor code, the new law for the central bank, and the introduction of rules on bankruptcy--are not small tasks.

We hope that the social safety net envisaged by the Government will be introduced as soon as possible, because considerable time will be needed for the positive effects of this excellent program to be felt by the lower-income population. In the letter of intent the Polish Government states that it chose to make radical changes because, among other reasons, of the poor results of the piecemeal reforms launched in the 1980s. We know that gradual policies do not lead to gradual adjustment, but, instead, to gradual or swift deterioration. However, no one should expect that radical changes will bring about rapid benefits. That this is true is a pity, but in a situation characterized by deterioration, radical policies achieve only gradual results.

We could continue commenting point by point on the fascinating program we have before us today, but we think that this is a case in which our judgment must be global, and looking at the program in its totality, it is overwhelmingly positive and strong enough for us to support the proposed decision warmly. It is true that the program is full of risks, but they are the kind of risks that emerge from ambitiousness and not from lack of determination. The close contact with the Fund and the projected reviews make a lot of sense, and we strongly support them.

We cannot end this statement without a list of commendations. First, we commend the courage and wisdom of the new Polish Government, and wish it success in all--not only economic--its endeavors. We also commend the staff, management, and Mr. Filosa. The United States also merits commendation, because the U.S. authorities were the first to realize that the present Fund resources were insufficient to give credibility to the program. The United States launched the initiative of supplementing the $545 million that the Fund can supply with its current quotas, and called on other countries to contribute $1 billion through an ad hoc stabilization fund. This is a typical case of a good program that could have failed because the Fund, with its present size, does not have enough resources to give credibility to the program. This is why Spain has supported and made a contribution to the Stabilization Fund. Finally, we commend the French initiative proposing a bank for reconstruction and development for Eastern Europe; it will be very helpful in sustaining all the reforms that now are just beginning in Poland and other Eastern European countries.

The Managing Director's letter to our Governors rightly notes that other players should follow this cooperative attitude. The scenarios prepared by the staff clearly prove that the contribution of the Paris Club and the commercial banks has to be substantial if the program is to be successful.

In our view, no developing country should be jealous of this extraordinary international support for Poland. It should be seen in a positive way, because Poland is setting important precedents for the success of any country in a similar situation that genuinely wants to adjust its economy. Poland has adopted one of the strongest and most complete adjustment programs examined by this Board, and the authorities are counting on a great deal of bilateral, regional, and multilateral support. All developing countries should be glad to sanction the establishment of these precedents, because later they could be legitimately used in similar cases.

Mr. Al-Jasser made the following statement:

I would like to join other speakers in complementing the Polish authorities on undertaking this dramatic shift in economic policy, which carries considerable risks but high pay-offs. This case is particularly important because Poland's experience will be watched closely by other Fund members and by nonmembers--with both centrally planned and mixed economies--with respect to not only the policy content, but also in terms of comparability.

I largely agree with the objectives and the policy mix of the program to be supported by the proposed stand-by arrangement. On the conceptual plane, the program provides for an appropriate mix of stabilization effort and strengthening of structural transformation. However, I am interested in some issues that are critical to the success of the Polish adjustment effort as well as to the evolution of Fund policy concerning the use of its resources. My expression of these concerns is in no way intended as a criticism of the program, which I find courageous and pathbreaking.

First, I see uncertainty about the financeability of the program, which is a cause for concern. More often than not, unavailability of the hoped for financing has tended to derail adjustment efforts. In the case of Poland, the financing gap, when assessed in the medium-term context and assuming a feasible adjustment path, remains very large, at around $25 billion for 1990-95. This is the most fundamental issue for the Fund's involvement and exposure in Poland. There are considerable risks involved, as the staff has rightly pointed out. While the economic problems in Poland were created over a period of more than 30 years, is it feasible to correct them in a short time span, which will require $25 billion of additional resources? I am not concerned about the amount per se, but whether this amount can be mobilized over this limited period, especially if there were to be slippages. There seems to be a state of euphoria in the Fund regarding this program that may make issues less clear at this stage. There is, therefore, a need to be careful with the use of Fund resources, which are precious. One of the possible ways of minimizing risks could be to stretch the period of adjustment a little longer and to make the availability of financing more feasible. Has a longer period of adjustment been considered? I would like the staff to comment on this matter.

Conceptually, I understand the desirability of a decisive, even ruthless, stabilization with a wholesale dismantling of controls on price and factor movements. In reality, the pace of price liberalization will be guided by the availability of financing, the extent of popular commitment, and the ability of state enterprises to maintain the necessary financial discipline. In particular, the stability of the exchange rate as an anchor will crucially depend upon the availability of convertible foreign exchange to defend it. Should adequate financing fail to materialize, would Poland be in a position to intensify its already tough adjustment efforts and further slow down growth? Even if Poland agrees, is there more room for this intensification? At the same time, if the requisite financing becomes available, should Poland accumulate additional debt with the consequent longer-term increase in the debt servicing burden? In other words, will Poland be able to repay in view of the somber balance of payments outlook? I would be very reluctant to see Poland significantly increase its external debt burden. Therefore, I would hope for a positive response from creditor countries to the Managing Director's letter stressing the need for debt restructuring.

Putting aside the financeability of the program, I, like Mr. Cassell, see difficulties in the sequencing of policy implementation. The program rightly calls for the development of a new system of indirect instruments for macroeconomic control. These will require the development of financial and capital markets, an independent central bank, and a more stable and realistic tax-subsidy nexus. I fully endorse the decision to maintain positive real interest rates as a means to increase the attractiveness of local currency deposits. However, until such time as financial markets and other instruments are developed, how would the private sector's financial decisions be interfaced with the goods market? It is also crucial that price liberalization and decentralization of decision-making proceed in concert with other institutional changes, so that the potential for triggering an inflationary spiral is avoided. In view of these considerations, it is essential that a tight credit policy is maintained, irrespective of what happens to interest rates and other costs, so that the financial discipline of the state enterprises will be ensured. In this context, I agree with Mr. Feldman that structural reforms should be undertaken in full, rather than partially. This may inevitably require a longer time.

Another issue relates to uniformity of treatment as regards policy prescriptions for Poland compared with those for other member countries. The most obvious case relates to policy concerning energy prices. Despite recent increases in the prices of coal-based energy, they remain substantially below comparable world market prices, and further increases in coal prices are not envisaged. This policy is clearly at variance with recommendations to raise energy prices, at least to the world levels, in other countries, especially developing countries. The staff has been critical of countries where energy prices, although above world market prices, have remained unchanged in the face of declining world oil prices. Even more interesting is the seeming discrimination between the pricing of oil-based and coal-based energy in Poland. What could be the rationale for discrimination against oil-based energy? To say the least, we should try to be consistent in our energy pricing prescription. I would appreciate having a clearly articulated statement of Fund policy on energy pricing.

I am happy to note that the program has paid due attention to the possible adverse income distribution effects, and that enlarged budgetary provisions have been made available for a social safety net. Additional assistance from abroad is being sought to strengthen this effort, which I applaud. As this conforms with the present Fund policy on poverty, I hope that it will be applied uniformly to all other cases from now on.

Similarly, the staff has called for freer access of Polish products to western markets as a means of facilitating adjustment, a proposal that I also support. This will be a good step toward integrating Poland into the world economy. This call should become a permanent feature of Fund reports, in order to promote the integration of all developing countries into the world economy.

I support the proposed decisions.

Mr. Orleans-Lindsay made the following statement:

I join other speakers in welcoming today's consideration of Poland's request for a stand-by arrangement in support of its stabilization efforts in order to pave the way for transforming the economy into a market-oriented one. I am in broad agreement with the staff analysis of recent economic and financial developments in Poland, and I share most of the views and assessments presented in the staff appraisal. The proposed decisions are acceptable.

The need for Poland to secure adequate and timely international financial support to enable the authorities to continue and intensify their efforts to undertake their program of fundamental economic reforms, to which they have shown a deep commitment, has been given wide international publicity in recent months. In this connection, I strongly support the Managing Director's commendable contribution in this area, particularly through his recent communication to Fund Governors and finance ministers, drawing their attention to the special financing needs of Poland to enable the country to progress toward a sustainable medium-term external position.

It is clear from the staff papers and previous speakers' statements that, over the past year, the authorities took important initiatives to restructure the central economic administration, reform the exchange rate system, and liberalize both the allocation of foreign exchange, and the agricultural and food sectors. When these initiatives proved inadequate to arrest the deteriorating financial situation, they were strengthened with a package of measures aimed at, among other things, introducing discipline into the system of wage determination and accelerating the process of price liberalization and adjustment.

The Polish authorities' determination to build on these measures and to further strengthen them in the context of a stabilization program for 1990 is encouraging. Furthermore, the measures constitute significant steps toward eventually moving the economy in the desired direction of a market orientation. I endorse the general thrust of this ambitious program, with its major emphasis on achieving a rapid and lasting deceleration in the rate of inflation and improving the overall supply situation. The liberalization and systemic measures in the program are a reflection of the authorities' strong willingness to succeed in their efforts to continue and expand the restructuring of the economy. And I note the provision of technical assistance from various sources to modernize the financial system and strengthen competition in the banking sector and the privatization of state enterprises. As Mr. Grosche has emphasized, measures in this area should be implemented as soon as possible.

All in all, I am impressed by the authorities' recognition that, given the need for the Polish people to make short-term sacrifices in order to benefit from long-term gains, they need appropriate measures to shelter some vulnerable groups from the effects of the needed rapid pace of program adjustment. Furthermore, I welcome the authorities' readiness to take additional measures should the broad aims of the program be endangered. Given that there is no economic blueprint to guide and steer centrally planned economies toward western practices, and especially since the program is not without significant risks, and as Mr. Grosche, Mr. Dawson, and Mr. Yamazaki and others have emphasized, the authorities should monitor developments very closely and institute contingency plans in the fiscal and monetary areas, as recommended by the staff. In this connection, I support the authorities' request for a resident representative in Warsaw.

Mr. Ghasimi made the following statement:

At the outset, we would like to extend our sympathy and encouragement to the Polish authorities for their determination in tackling the widespread difficulties and in embarking on a far-reaching economic and financial program aimed at transforming and modernizing their centrally planned economy.

As it appears from the staff reports, as well as from Mr. Filosa's statement, the stabilization element of the program, designed to halt the hyperinflation and the balance of payments deterioration, as well as to reduce domestic demand, is rather ambitious, rapid, and comprehensive. In our view, three major elements will be crucially important in safeguarding the success of this program. First, the commitment of the authorities to act rapidly and to implement the program with determination should be continuously present. In this respect, the measures implemented recently in the areas of exchange rate, wage determination, price liberalization, and the budget deficit constitute positive indications of the ability and determination of the authorities to restore financial discipline. Second, the financial support of the international community should be appropriate and timely in order to help the authorities to carry out the difficult economic program and to sustain the stabilization of the exchange rate, the expected surge in imports, as well as any unexpected pressure on demand for foreign exchange. Third, and most important, the program is highly dependent on the understanding of the public, which will inevitably suffer in the short term from the negative effects of the stabilization program, and especially the reduction in living standards and growing unemployment. In these circumstances, we, like Mr. Al-Jasser, find the inclusion in the program of wide-ranging social policies aimed at alleviating the immediate hardship for the population most appropriate.

Beyond its stabilization element, the program is also designed to change a controlled economy into a market-oriented one, and, in many respects, the program appears to be somewhat radical. The objective is to move rapidly to an economic system with market mechanisms and institutions designed to help improve efficiency and resource allocation, as well as sustain competition in a decentralized environment.

It is clear that the program constitutes a real challenge not only to the authorities but also to the Fund, and we note the significant risks referred to by the staff and by the Managing Director in his letter to the major creditors of Poland. We agree that close monitoring of economic and financial developments by the authorities and the Fund will be crucial in order to reassess continuously these risks and to adopt policies to changing circumstances. We also believe that, in the case of Poland, technical assistance is as important as financial support and will be a key element in helping the authorities in the implementation of the program, as well as in the design of the necessary administrative and legislative changes.

The economic changes in Poland, as well as in the rest of Eastern Europe, are perceived to constitute a challenge for many developing countries. We only hope that the focus of attention, as well as the mobilization of financial support, investment, and technical assistance to many deserving countries in Eastern Europe will not influence the ability of creditor countries and international financial institutions to continue their support for developing countries undertaking sound adjustment programs. In any event, we believe that the opening up of Eastern Europe to foreign trade and investment should constitute a positive opportunity for many developing countries to expand their exports and other economic relations with these countries.

We support the proposed decisions.

Mr. Evans made the following statement:

The staff appraisal in this report is the most fulsome I have seen in terms of its praise of the authorities' program and its advocacy of the proposed arrangement. To a large extent, that is understandable, given the nature of the case and the considerable input both staff and management have made to the program, and given the fact that the authorities' efforts, including the actions taken to date, deserve the highest commendation. Nevertheless, I believe that the role of advocate is best left to the Executive Director representing the country. The Board looks to the staff appraisal to provide a balanced and objective assessment. I think that this one falls a little short of that requirement; and the assessment of Poland's ability to repay the Fund, presented in one very brief paragraph on page 21 of the report, could most kindly be described as cursory.

But I offer this rebuke in the mildest possible terms and, in doing so, I commend the staff for the thoroughness of its background analysis and the dedication it has shown in assisting the Polish authorities. However, as many speakers have noted, we will be looking at Poland on a continuing basis in the future, and the Board will be relying heavily on objective statements from the staff.

It is true that the program will have very high risks attached to it, but, unlike many other cases we have considered, those risks derive less from the program or the policy commitment and instead are inherent in the starting position which, of course, cannot be changed. To paraphrase Mr. Fernández Ordóñez's comments, some risks are more palatable than others, and those involved in this program must be embraced by the Fund and the international financial community wholeheartedly.

While on this topic, I would like to comment briefly on Mr. Kafka's observation that a program must be formulated so as to be politically acceptable. I agree with that comment in the sense that a program that is not politically acceptable will be doomed to failure; but I am afraid that that does not take us very far, and the Fund could not take Mr. Kafka's dictum as being the sole or prime consideration. I would be inclined to reformulate his remark as follows: a program must be formulated so as to be economically acceptable and should be implemented when it becomes politically acceptable. This, I believe, is what has happened in Poland, and one of the main tasks ahead of the authorities will be to ensure that the program remains politically acceptable. On that score, I agree with previous speakers who have stressed that safety nets and retraining programs will be essential.

On the details of the program, I would like to comment on one aspect that causes some concern and on which I would appreciate a comment from the staff. The authorities have placed a good deal of emphasis on relative price adjustments, both through the exchange rate and in domestic markets. That is commendable and is what we would look for in a normal Fund program, but the increased flexibility in this case is entirely in product prices; factor prices are being constrained severely, consistent with macroeconomic policy requirements. As a result, there is some question whether the necessary allocative effects are likely to take place. In particular, are institutional changes needed in labor markets? In asking that question, I would stress that I do not believe that countries in Poland's present position can afford the luxury of academic concepts such as sequencing. What is needed is a comprehensive program. One cannot avoid the need for the constraint that is being put on wages, but there is a problem there.

I fully support the proposed decisions.

Mr. Kafka said that he fully agreed with Mr. Evans that a program must be both politically and economically acceptable, and Mr. Evans had proved that conclusion in stressing the necessity of the safety net, which made the program both economically and politically acceptable. Without the safety net, the program would not be politically acceptable.

Mr. Arora said that the Managing Director's close involvement in the formulation of the Polish program was welcome. The present discussion was a historic event: just as the establishment of central planning had been a major event in world history, so was the switch back to a market economy.

The program would have been remarkable even if Poland had not been facing serious disequilibria evidenced by hyperinflation and a sharp rise in the current account deficit, Mr. Arora commented. The program's importance had increased significantly, because it was not simply stabilizing the economy--which in itself was cause for satisfaction--but also leading to systemic changes in an incredibly short period. There were some models that suggested that markets could work under socialism, but that obviously had not happened in fact, and there was no model for the ongoing reform process in Poland. In the circumstances, the staff had appropriately shown humility in grappling with the very complex problems raised by the case of Poland. One could not be dogmatic in dealing with that case; developments could not be forecast with great confidence in the degree of accuracy. The program must be approached with great caution and a sense of balance.

In his view, four issues concerning the program were of particular relevance, Mr. Arora commented. First, as previous speakers had stressed, there was clearly a need to maintain and strengthen the social consciousness about the program. In that context, the social safety net was of critical importance. As conditions became more difficult with the implementation of stringent measures, the Fund and the authorities would have to show great understanding in order to maintain and strengthen the social consensus.

Second, the program was being undertaken in conditions that included a serious debt overhang, Mr. Arora continued. Therefore, from the very start, there were serious impediments built into the success of the program. The staff had correctly noted that, unless there was a generous and sustained response from the international community, the situation would be very tough, indeed, and a successful outcome could not be taken for granted. Developments must be carefully watched by the staff and management to encourage the provision of adequate debt relief and debt reduction for Poland. Without that relief, serious and unnecessary problems would be created for the Polish people.

Third, irrespective of how much time it would require in the coming period, and despite the expected decline in output and employment in 1990, inflation must be fought. However, the effort must lead to growth, which in turn would require a fairly significant increase in investment in critical sectors of the Polish economy. As Poland was expected to accumulate a trade surplus, the investment requirement might not be met in the absence of direct capital flows to substitute for domestic savings. It was not clear to him whether that kind of investment scenario would actually come about. He wondered whether investment should not eventually--at some later stage--be a prominent factor in the performance criteria.

Since there was no model for the kind of adjustment being attempted by Poland, and since the problems facing the authorities were complex, the Fund must employ a certain balance and imagination in judging how the program was going, Mr. Arora commented. Mechanical reliance on performance criteria that had to be observed by a certain date might not be the right response to the kind of situation Poland faced. While the staff and Mr. Filosa had said that the Polish authorities would be prepared to make an immediate response in the event additional measures were needed, the Fund, too, should be prepared to show greater flexibility in judging developments in Poland; otherwise, the Fund might well soon be disappointed by Poland's program.

Mr. Posthumus made the following statement:

> We support the proposed stand-by arrangement for Poland. The authorities are to be commended for the courage with which both the economic adjustment and the economic reform have been tackled since September 1989. I hope that the length of my statement in this respect is not considered a measure of the size of our support for this important program.
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> The risks are clearly very great. The two anchors should hold. Monetary policy has a very important task: lowering interest rates--a general request by politicians--too early and too much would affect the credibility of the program. Like Mr. Grosche, I commend the authorities for their decision to make the central bank an independent institution. This decision highlights the importance that we should attach to the institutional

aspects of setting up market economies after the collapse of so many command economies. The institutions that carry out fiscal policy, monetary policy, and supervisory policy must be ready to keep those market economies in macroeconomic balance. Wage policy, the other anchor, is of course very important as well, and the fact that the real wage reduction has been spelled out so clearly may actually help, rather than hinder, the implementation of this very difficult part of the program.

An even greater risk obviously is how the structural reorientation of the productive system will take place, and how much reorientation will have to take place. Macroeconomic adjustment must not be gradual--especially in periods of high inflation, often caused by too early price liberalization in economies that are very liquid and have no institutions to control liquidity. If stabilization results, but high unemployment and no growth also occur, then there will be greater problems than those in market economies that suffer from high inflation and imbalances and that follow adjustment policies and see some increase in unemployment. External financing, including measures to decrease the outflow of savings, is crucial, as Mr. Arora has stressed: there is a need for foreign investment, and not only investment to buy the enterprises that are privatized first of all; new credits, and the terms of rescheduling of official and private creditors, are obviously important issues.

My Dutch authorities understand that in this very special case the Managing Director has brought to their attention the urgency of granting exceptional treatment for Poland by all external creditors. They hope that in future cases the regular procedures will be followed. They have not yet been able to decide on a policy in this respect. I think that in situations like this one the Fund's position should be that of an honest broker, which means that, in the framework of good programs, the possibilities and problems of both the creditors and the debtor should be taken into account. The Polish program should not fail because the creditors cannot or will not do what is in their power to do; in this case, the overfinancing mentioned by Mr. Grosche seems to me a rather optimistic fear.

It is not clear to me the why the staff considers the arrears as a government default and not as exchange restrictions; an explanation by the staff would be welcome. Also, I share Mr. Grosche's concern about the size of the proposed access, obviously not because Poland's program is not strong, but rather because I am increasingly concerned about the size of the quota increase which seems possible; I think that we will have to scale down somewhat our financing of adjustment programs. It is interesting to note, as Mr. Fernández Ordóñez did, that if the Fund would have been allowed by its members to grow more in line with the world economy, the Stabilization Fund would not have been necessary in the Polish case; a stand-by arrangement for an amount less than the Stabilization Fund could have done the same job and more efficiently.

I hope, like Mr. Feldman, that the approach taken and the success of the Polish program may give an impetus to other countries, and to the realization that gradual adjustment is not better than fast adjustment. And like Mr. Cirelli, I very much support the Fund's role in this process of helping move an economy from a command to a market economy. This approach may well be of particular interest to a country in our constituency, Romania.

Mr. Dai made the following statement:

The Polish economy experienced great difficulty in 1989, when growth in real output fell to a negative level, while inflation surged substantially. The balance of payments position continued to deteriorate, owing to the sharp reduction in exports and the increasing debt service burden. Excessive demand, resulting from inappropriate income distribution in the past, remains, among other causes, the major factor in Poland's deteriorating economic situation.

The authorities' main challenge is to restore growth and balance of payments viability while curtailing the high rate of inflation. In the present specific circumstances in Poland, the authorities, on the basis of their judgment, have chosen and formulated with Fund assistance a comprehensive and speedy adjustment program to tackle their economic problems. This program is also largely based and dependent on vast anticipated international support in various forms from a number of foreign governments. Meanwhile, because of uncertainties surrounding the outcome of policy measures in the program, it is essential that the authorities stand ready to take additional measures should the circumstances warrant further action.

With respect to adjustment by enterprises, the stabilization program contains three major elements: use of the exchange rate and wages as nominal anchors to arrest inflation; restoration of balance in the general government's position; and implementation of a tight monetary policy to contain the price and demand consequences of economic liberalization.

It is obvious that most of the measures embodied in the above three elements will have a strong impact on enterprises. The fundamental issue, therefore, is the extent to which enterprises can bear the consequences of adjustment measures and eventually maintain viability while facing a tighter financial environment and the withdrawal of subsidies. The reaction of enterprises will certainly have an impact on output and employment. When an enterprise is under budgetary constraints, the management has to decide if it should maintain employment while reducing the real wage level or lay off workers. While welcoming the strict measures already taken by the authorities to discipline wage awards, I would be interested in learning what other immediate measures are being employed to enhance incentives and prevent output from falling further.

It is essential to have a disciplined fiscal policy in the fight against inflation. According to the staff, the budget's biggest burden, in addition to subsidies, is debt servicing. The authorities have planned to reduce subsidies by more than half in relation to GDP compared with past reductions. Table 4 of the staff report shows that the reductions in subsidies are the most drastic when compared with the other items on the expenditure side. Reductions in subsidies, together with reductions in real wages, will inevitably have an adverse impact on living standards. In this respect, it is appropriate that the Government has enlarged some of the budgetary provisions for social safety nets to shelter the most vulnerable segment of society against the immediate impact of the corrective adjustment.

It is my understanding that Poland will in all likelihood be provided with substantial debt relief, particularly from official creditors. I wonder how this development will affect the budget and whether it has been taken into account in the projections for the 1990 budget. According to the staff, even with substantial expenditure cuts, a sizable deficit is anticipated in the first quarter of 1990.

As to credit and monetary policy, the authorities have taken a wide range of restrictive measures, such as releasing control over interest rates and containing net domestic credit. As a result, both money and credit growth have been reduced substantially. It is important that this tendency continues throughout the program period, so that the two-anchor mechanism can work effectively.

I noticed from the staff report that foreign currency deposits account for a large proportion of banking system liabilities in Poland and are largely in the form of time deposits, while domestic currency deposits are held in the form of demand deposits. Because households have legal access to the parallel markets in foreign exchange, can hold balances in foreign currency, and can utilize their foreign currency to purchase imported goods, As far as 1990 is concerned, we have noted that the authorities intend to request full rescheduling of arrears and debt service falling due, while the staff believes that a rescheduling of 85 percent of arrears and debt service would be consistent with program assumptions and the reserve target. Since currently no debt service is being made by Poland, the question does arise whether, in the meantime, and pending an agreement with creditors, the reserve target should not be higher than the one which is based on an 85 percent rescheduling. The staff may wish to elaborate on this point.

Given the circumstances of this case, we can support the proposed decisions. However, like others, we hope and expect that, by the time of the first program review, substantial progress will have been achieved toward an agreement between Poland and all its creditors.

Mrs. Sirivedhin made the following statement:

I congratulate the Polish authorities on the bold and refreshing program they have embarked on. I accept the proposed decisions.

It appears to me that Poland has at least four ingredients of a feasible program: strong front-loading of measures; a good balance of stabilization and structural policies; close monitoring and readiness to take additional measures if necessary; and the requisite financial support from the international financial community. I will comment on each one of these.

First, wisely taking advantage of the momentum of strong public support, a radical approach was chosen instead of the piecemeal gradual approach that had proven unsuccessful in the past. Drastic measures covering wages, expenditure cuts, accelerated tax payments, credit policy, and exchange rate policy were begun without delay. This effort has already started showing a positive effect on inflation and is a sound basis for the measures that are to follow.

Second, the program for 1990 seeks to simultaneously address the weaknesses of the Polish economy in two well-balanced ways: stabilization of the economy, and adjustment of the economic structure by moving toward market mechanisms. With regard to stabilization policy, I note with particular interest that, following a sharp depreciation of the currency in order to achieve export competitiveness, the authorities intend to hold the rate steady during the coming months in order to resist inflationary expectations. Subsequently, the real exchange rate will be based and the authorities' own judgment about the willingness of the public to accept the short-term adjustment burden. Under these circumstances, one finds it difficult to offer much in terms of advice.

The staff report itself has correctly focused on the high degree of uncertainty which, though always present in adjustment programs, is probably even greater in this case given the nature of the program and the lack of relevant experience. The report has very usefully pointed to the potential risks involved both in implementation and in the response of economic agents and the public at large to policy changes. The transitional costs of adjustment are likely to prove quite high in this case, and the authorities have done well to try to establish a safety net to mitigate these costs. But this remains a major source of uncertainty, particularly since these costs are likely to occur very early in the program, while some of the institutional infrastructure necessary for an effective safety net does not appear to be solidly in place.

Another major source of uncertainty is the fact that the program is built around very specific assumptions about the timing and movements in macroeconomic variables. A deviation from these assumptions is not unlikely, and, therefore, contingent policies may prove crucial in this case. While in some areas contingent policies are spelled out by the authorities, in other areas, such as fiscal policy, the authorities' response to possible deviation is not as clear.

Along with reducing inflation and moving the economy toward market mechanisms, correcting the external imbalance is a major medium-term objective of the program. The staff's medium-term scenarios are particularly useful in bringing out the implications of growth and debt assumptions for medium-term balance of payments viability. However, the staff's analysis has been more or less limited to movements in imports and exports and "debt capital." One would have expected the medium-term analysis to incorporate the likely flows of nondebt-creating capital. In Poland's circumstances, one would expect direct foreign investment to play an instrumental role over the medium term, not only in boosting output and growth, but also in putting the overall balance of payments on a viable course. Very little is mentioned in the report on this issue, and perhaps the staff can comment on what it sees in terms of the potential for, and the role of, direct investment in Poland in the coming years. More specifically, the staff could also indicate the assumptions about nondebt-creating capital flows that have been incorporated in the medium-term balance of payments projections.

they tend to hold their zloty balances in the form of demand deposits. This tendency has led to the instability of financial resources denominated in domestic currency which are needed to finance domestic investment. As the population at large is usually reluctant to place domestic currency holdings in time deposits in periods of high inflation, I wonder what instruments other than interest rate measures would be feasible in Poland to increase the attractiveness of longer-term zloty deposits.

As to the balance of payments prospects, although the zloty has been substantially devalued, the current account will remain weak in 1990, owing to the expected fall in domestic production and the increasing debt service burden. Moreover, maintaining a certain level of imports is crucial for the revitalization of economic growth. The international community's support in providing debt relief in addition to balance of payments financing, stabilization funds, social safety net funding, food aid, and other measures, is therefore of vital importance to Poland. In sum, the need for external financial assistance is unusually large and comprehensive, and commitments of support from the developed world appear unusually strong and efficient. Without such support, program implementation would be very difficult, if not totally impossible.

I support the proposed decisions.

Mr. Finaish made the following statement:

As many Directors have already stated, the program before us today is an extraordinary one in many respects, including the radical approach being followed in reducing inflation and stabilizing the macroeconomy, and the swift structural and systemic transformation that the authorities are trying to achieve. But this case is also exceptional for two other reasons, namely, the high degree of interest and attention that Poland's program is attracting, and the level of support that the international community is willing to provide to help Poland succeed in making this historic crossing. The Board's outright and strong endorsement of the arrangement and the amount of access being requested are a reflection of that exceptional degree of support.

The authorities' eagerness and determination to move quickly on both the macroeconomic and structural levels have been amply manifested by their actions since last September and by the far-reaching measures envisaged under the 1990 program, many of which have in fact already been put in place. The authorities have defined their objectives and priorities clearly. The program is also based on a clear recognition of the potential risks involved on a policy of preserving competitiveness in light of labor costs. The highly restrictive tax-based incomes policy that has been introduced should also help in reining in inflation expectations. It is good that understandings could be reached beforehand with the labor movement. Fiscal policy will be very restrictive. In view of the weak capital structure, however, I wonder how long the Government can go on without needing to incur sizable infrastructural outlays. Credit policy is in the right direction, as are the policies on prices, the exchange system, public enterprises, and the banking system. I note the likelihood that Poland's trade with the Western world is likely to increase and would like to know the staff's views on the potential effects of this evolution on the trade of developing countries. I also note with interest the authorities' intention to implement so-called social safety nets, which would provide benefits in cash and in kind to the most needy and which should help maintain the political consensus. With regard to unemployment benefits, the authorities no doubt realize that care must be taken not to let them become work disincentives or to overburden the fiscal budget. The focus must be on retraining and improvement of labor mobility.

Third, the program is not without risks and has no obvious precedent. Moreover, Poland's ability to service its large external debt is not easily apparent. There is, therefore, absolutely no room for slippage. The staff has rightly emphasized the importance of close and continuous monitoring of developments and the need to stand ready to take additional measures if necessary. I am pleased to learn that the authorities are also committed to this view.

Last, but not least, the financing gap of Poland is enormous. As Mr. Filosa has stressed, the success of the program hinges on the support of the financial community. I am pleased to note that this support has already started to be forthcoming and I am hopeful that, with the approval of this stand-by arrangement, negotiations with the Paris Club and with commercial banks will come to a satisfactory conclusion. I look forward to continued Fund commitment in the area of technical assistance and the establishment of a resident representative office in Poland.

Mr. Fogelholm made the following statement:

The program before us is in many ways unique, unprecedented, challenging, and, undoubtedly, extremely risky. But it is a risk that has to be taken. The Fund cannot afford to stand on the sidelines when history is in the making. One can also ask if there is another institution that could have stepped in and replaced the Fund in assuming this challenge.

The new Polish Government deserves to be commended. After taking office in September last year, it immediately began the unavoidable economic adjustment process, including, inter alia, courageous incomes policy measures and a rapid adjustment of relative prices. As the Polish economy is characterized by deep-seated structural problems, it is essential that the initial stabilization be followed by a medium-term structural adjustment program--for example, in the form of an extended arrangement.

The Nordic countries support Poland's request for a stand-by arrangement. The program seems to be a very strong one. This chair applauds the authorities' choice of aiming at a swift transition from a planned to a market economy. We also agree with their judgement that a gradualist reform approach would probably have much less favorable prospects for success than the present program. But, obviously, a rapid restructuring of the economy implies a fair degree of uncertainty, which makes it necessary for the Fund to closely and continuously monitor developments. Needless to say, the Polish authorities should also stand ready to implement additional measures should the need arise.

I agree with the staff appraisal and will make a few comments on the program. The first and foremost goal of the stabilization policy is to contain the inflation. To succeed, the authorities need to be able to carry through their income policy according to plan. In this regard, the penalty taxes for excess wage increases should indeed be activated if necessary to ensure that real wages are being reduced. We believe that the inclusion of wage developments among the performance criteria is a positive sign.

The fiscal and monetary stances should, of course, support incomes policies and should be adequately tight. We are pleased to note that the plans for budget policy are ambitious and that the general policy of subsidization, in particular, will be abolished to allow for more targeted efforts to assist those groups most affected by the reforms. In this context, we can go along with the staff's recommendation that foreign contributions could be used for the social safety nets.

The monetary and exchange rate policies should be employed also with a view to reducing the role of deposits in foreign currency and building up the domestic money and capital markets.

We agree with the basic thrust of the program to correct the relative prices in the economy. Without such a development, the planned shift in the economic structure is doomed to fail. In addition, we wholeheartedly subscribe to the proposed measures in the area of structural reforms, including privatization and other measures to transform the structure of ownership. I agree with other Directors that no partial reforms can be allowed in this field.

In order to assist Poland's adjustment process, this chair can accept the proposal that the program be supported by Fund financing in the absence of financing assurances. It is clear from the staff report that Poland needs a substantial restructuring of both its official and private debt. It is equally clear that this will require many imaginative proposals from all the parties concerned in the near future.

We look positively on the authorities' intention to treat different creditor groups equally, a policy which, we believe, will help cover the large financing need in 1990 and beyond. The requirement of equal treatment should be stressed because for several years Poland previously discriminated against the official creditors. If for some reason--and I agree that prospects for this look slim--the program should turn out to be "overfinanced," this should lead to a strengthening of the net international reserves target.

I support the proposed decisions.

Mr. de Groote made the following statement:

I would first like to deal with a remarkable aspect of the Polish program, one that relates less to Poland's situation in itself than to the new responsibility the Fund is accepting in Central and Eastern Europe: like the other major players in the international community, the Fund has recognized the historic significance of the evolution taking place there. By helping the Polish authorities to devise a program that goes beyond conventional stabilization to reach deeply into structural reform, this institution is explicitly assisting them in making the transition from a command to a market system. Although some elements of this nature have already been included in previous Fund-supported programs in Eastern Europe, this is the first program that clearly reflects the acceptance by the Fund of a more active involvement in systemic reform. The systemic orientation of the program is shown by the expected transformation of the present stand-by arrangement into a three-year extended arrangement, by the Polish authorities' intention to organize their policies, during the course of the stand-by arrangement, around the possibility of achieving such a transformation, and by the structural nature of the changes introduced at the very outset of the program--for example, in the area of foreign exchange policies.

We should be especially glad of the readiness of the Fund's management to take up the challenge in Eastern Europe, because this is the Fund's only chance of doing so: failure by the Fund to become an active presence at this very moment, in the transition of these countries, would have made it likely that the transition would follow, for a long time, a disorderly course.

The rapid developments in Eastern Europe have overtaken the general approach of the papers prepared for our seminar on centrally planned economies, and rendered obsolete most of the concepts they present. In a very short time it has become self-evident that we should no longer regard the possibility of reforming centrally planned economies as an alternative to introducing the market system. It is now clearly perceived that the command system itself was part and parcel of a political system of domination, a political system which the ongoing changes in the Soviet Union now allow to be replaced in Eastern Europe by parliamentary forms of government based on democratic principles. We need therefore have no doubt that, in the minds of the populations of this part of Europe that has just regained its independence, there is no choice to be made between the system that usurped the name of socialism and the one which was slandered under the name of capitalism. The new policymakers in these countries insist that central planning was never chosen, but was imposed on them by outside political forces, and that it led their countries to an economic and social dead end, to a political immobility which masked deep crisis, and to human degradation. They are therefore of the view that this system is no longer to be regarded as a legitimate object of choice. It is also a matter of great disappointment in these countries that so many intellectuals in the West should have failed to see what was obvious all along to the people who were forced to suffer under one of the most lasting failures in human history. I am particularly gratified that, thanks to the personal inspiration of the Managing Director and the European Department's enthusiastic dedication, the staff has not missed the opportunity to be part of the transition of these countries to a dynamic acceleration of their economic development and to the reorientation of their foreign economic relations.

For this transition to succeed, it will be crucial to ensure that Fund-supported programs include, besides the traditional measures, schemes for effectively helping to re-establish the dominance of private ownership in industry, agriculture, and services, as well as designs for the institutions and mechanisms of the free market, and plans for integrating these economies into the EFTA and EEC.

I would like to comment briefly on two aspects of the program which embody measures specifically structural in nature, namely, exchange rate policy and the wage policy.

I am particularly glad to see that the official exchange rate of the zloty is to be established on the basis of its market rate in convertible currencies. This is indeed an innovative step. The unified exchange rate established in this way is much closer to reality than the artificially unified exchange rates that still exist in other Central European countries, where the transactions involved have not been genuinely liberalized; the unification of official exchange rates is realized there in name only. Therefore, I congratulate the staff and the Polish authorities for having brought about the region's first real progress in exchange rate policies. Until now, in this part of the world, the field of exchange rates has been the exclusive and favorite playground of the most dogmatic set of pseudobankers ever seen.

I also welcome another very innovative feature of Poland's newly adopted exchange rate policy--its support by, and integration into, monetary policy. Local savings, which took refuge in foreign currencies, should now flow back into zloty assets and allow monetary policy and exchange rate policy to support one another. This is another unheard of step in the region where, in most cases, foreign exchange is handled secretly, like a mystical fetish, in hermetically sealed sanctums where self-appointed shamans hold sway. I hope that these first important steps will be followed by others, and will soon lead to the establishment of the zloty's true convertibility, which is a very important precondition of the country's integration into the world economy. What could Poland expect, over time, from a nonconvertible currency, if the currency of all its Western partners is convertible? Mr. Fernández Ordóñez has made an eloquent plea to eliminate the remaining restrictions in the exchange and trade regimes, and especially to abolish the remittance obligation. No doubt, he is right in principle; but such changes should not be attempted until the country has enough resources at its disposal.

The other nominal anchor of the Polish stabilization lies in the area of wage policies. I could only accept the program's solution, which is heavy taxation of wage increases, as a temporary one. In the longer term, the determination of wages ought to be mediated by market mechanisms and lead to an overall balance between purchasing power and resources. This, I submit, requires a balanced interaction between organized labor and privately owned enterprises, in which the trade unions play an active and responsible role opposite the effective ownership control of the enterprises created by privatization. Under the present Polish system, in which 90 percent of production originates in state enterprises, the managers grant wage increases to their employees and to themselves. Unlike managers elsewhere, they do not have an owner's long-term incentive to preserve and increase the value of the enterprise's assets; their first incentive is to increase wages, and to do so they are in a position to use any means at their disposal, including distribution of the depreciation allowance. Consequently, it makes a lot of sense to maintain, under Fund supervision, administrative limits on wages during a transition period.

For the forthcoming extended arrangement, however, the staff could adopt a different approach: in the sectors undergoing privatization, wages could be fully liberalized and subjected only to the normal personal income tax. This could provide an additional incentive for privatization. In the state sector, wage scales could be reintroduced at both managerial and employee levels, with the scales controlled by the relevant ministry, under the Fund's guidance. In fact, the risks incurred by both managers and employees in state-owned enterprises are not very different from those incurred by administration officials. None of them puts his own private property at risk in the operation of the enterprise. Only an owner can bear such a risk. A system that clearly recognizes the government's responsibility for managing the wages of state economic enterprises would better reflect reality, be more transparent, and leave less scope for manipulation.

As to fiscal policy, I agree with the program's implications. Nothing can be durably achieved without a comprehensive budget and tax reform. I hope that I am correct in understanding from the staff papers that these reforms will be the centerpiece of the forthcoming extended arrangement.

On credit and monetary policies, I have a question for Mr. Filosa and the staff. Since it is recognized that the Polish policymakers intend to press for development of the private sector, and to privatize large segments of the economy, would it not be desirable for them to promote these goals through monetary and credit instruments as well? In Poland, as elsewhere in the region, savings are generally insufficient to support large private investments or large-scale privatization of state enterprises. Only foreign investors have sufficient funds to launch large private enterprises in today's Poland. But could a corrective measure not be brought into play? One remedy might consist in reserving preferential treatment for the private sector and giving it favorable conditions for the development of private enterprises in the form of additional rediscount quotas as well as interest rate and maturity advantages. If I remember correctly, incentives of this type were set in operation in several Western European countries during the reconstruction period in the immediate postwar years, especially in Germany. Also, in addition to such incentives, do we not have to consider privatizing the commercial banks in order to support the privatization of the economy? If I may cite the case of another country, many observers believe that it was a mistake, in the early stage of the Hungarian banking reform, to leave the newly created commercial banks in the hands of the state, or let them be owned by the state enterprises that were their main customers.

I will now comment on the social safety nets needed to offset the effects of this very courageous program. The program's focus on its unavoidable employment effects is another highly innovative aspect. It is wise to avoid, from the very outset, the illusion that the adjustment process can take place without major hardships for the population in a country where per capita income is no higher than about $2,000. The staff report suggests that the Polish authorities should devise a contingency plan, especially in the areas of fiscal and monetary policies. I agree with the staff that it is important for the Polish Government not to hesitate to carry out its decision to eliminate tax relief and adjust interest rates if the inflation rate remains higher than anticipated. I doubt, however, that such a contingency plan can be effectively pursued unless it is strengthened by counterparts from the international community. Creditor countries will have to stand ready to take contingency actions through all stages of the Polish program, as they were throughout the reconstruction of Western Europe. A special role in this connection seems to be reserved for the Paris Club. Given the forecasts submitted for our attention today, I do not see how the program can be durably pursued without generous debt restructuring, especially from official creditors, who own a large fraction of the Polish debt. I would be grateful to the staff if it could mention the specific modalities such relief could take. Do we have to consider rescheduling of principal and interest due, and should we envisage concessional terms for rescheduled interest service? Examination of this issue would be greatly furthered if the staff could provide us with figures on the current value level of per capita assistance that would have to be given today to Poland in order to match the contribution made by the Marshall Plan to the population of, say, the Federal Republic of Germany or the Netherlands. Given the likelihood that governments will not be able to provide a comparable amount of assistance, what would be the implications for the Fund's potential contribution?

Apparently the safety net issue has not been perceived as being of the highest priority in the design of the program. There may be good reason for this: full restoration of the opportunity for private initiative to be the motor of the recovery might very quickly offset the unemployment effects of the measures, as was the case in the Federal Republic of Germany and in Belgium, where very high unemployment in the months immediately after the war's end rapidly gave way to full employment as the reconstruction activities gained momentum with the impetus of private investment.

Previous speakers have all stressed the risk inherent in the program. It is a risk that the Fund can and should accept. My confidence in the program's chances for success ultimately rests on the similarity of Poland's situation to that of the Western European countries after the war, when liberation from another totalitarian system gave our populations the courage to embrace such harsh programs as those carried out in Germany under the leadership of Professor Erhard; in Belgium at the instance of Mr. Gutt, later the Fund's first Managing Director; and in the Netherlands, under the guidance of Mr. Lieftinck, who served for a long period on the Fund's Board. As in Poland today, the people in those countries knew what they had to do to protect the freedom they had earned. How closely the situation in Eastern Europe resembles the postwar situation in Western Europe was made very clear to me recently, for I happened to be in Budapest on the day the Hungarian Government made its decision to open its borders with the West. Everybody there knew, when this decision was announced, that it was the beginning of a new era for Eastern Europe of both freedom and effort.

I strongly support the proposed decisions.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/90/13 (2/2/90) and EBM/90/14 (2/5/90).

2. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/90/32 (2/2/90) is approved.

APPROVED: October 24, 1990

JOSEPH W. LANG, JR.
Acting Secretary