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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/169

10:00 a.m., October 15, 1986

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	Mawakani Samba
C. H. Dallara	
	P. Péterfalvy, Temporary
	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
Huang F.	
J. E. Ismael	
	J. R. N. Almeida, Temporary
T. P. Lankester	
H. Lundstrom	
	L. Leonard
	A. Abdallah
	J. J. Dreizzen, Temporary
	A. Ouanes, Temporary
	J. de la Herrán, Temporary
H. Ploix	S. de Forges
	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	
A. K. Sengupta	
S. Zecchini	

L. Van Houtven, Secretary
A. Akanda, Assistant

Also Present

A. Dorosz, Vice Minister of Finance of Poland; A. Legatowicz, Member of Parliament of Poland; J. Boniuk, Financial Counsellor, Embassy of Poland. IBRD: P. Nouvel, Europe, Middle East, and North Africa Regional Office. European Department: L. A. Whittome, Counsellor and Director; P. B. de Fontenay, Deputy Director; B. Rose, Deputy Director; P. C. Hole, J. Prust, H. O. Schmitt, K. A. Swiderski. Exchange and Trade Relations Department: J. T. Boorman, R. L. Sheehy. Legal Department: A. O. Liuksila. Research Department: T. A. Wolf. Bureau of Statistics: W. Dannemann, Director; M. J. Ellyne, B. Gurgen, I. Szalkai. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: A. Bertuch-Samuels, F. Di Mauro, W. N. Engert, R. Fox, V. Govindarajan, O. Isleifsson, A. R. Ismael, V. Rousset, G. Seyler, B. Tamami, L. Tornetta, H. van der Burg.

1. POLAND - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV Consultation with Poland (SM/86/243, 9/16/86; and Sup. 1, 10/14/86). They also had before them a background paper on recent economic developments in Poland (SM/86/248, 10/1/86; and Sup. 1, 10/2/86).

Mr. Andrzej Dorosz, Vice Minister of Finance, represented Poland. Mr. Alexander Legatowicz, Member of the Polish Parliament, and Mr. Jan Boniuk, Financial Counsellor at the Embassy of Poland in Washington, were also present.

Mr. Dorosz made the following statement:

> The report prepared by the staff for the 1986 Article IV consultation shows clearly that the staff has a sound understanding of the Polish economy and of its specific characteristics and problems. As in a number of other socialist countries the Polish system of economic management is now undergoing a period of transition. Naturally, there are differences of approach between these countries due to the different circumstances facing them; it is especially important, therefore, to identify what is unique in each country's situation and policy. In Poland, we believe that our economic reform uses an approach similar to that which underlies the Fund's own views. A welcome feature of the staff report is the careful and thorough statistical analysis and presentation of data. We believe that economic data in Poland provide the basis for well-informed policy decisions and we will be providing comprehensive data to the Fund on a regular basis for inclusion in International Financial Statistics and for other purposes.
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> To be succcessful, any attempt to solve Poland's domestic and external economic problems must have as its foundation an increase in the economy's rate of growth, which, in turn, must in our circumstances be achieved through an increase in the economy's efficiency and in its export orientation and participation in the international division of labor. Consistent with these broad objectives, a vital role will be played by adjustments in our price system and in the structure of prices in our economy. We see such measures as indispensable if a more rational allocation of resources is to be achieved. Equally important will be the implementation of changes in organizational arrangements and the introduction of more competitive market structures. A key role will also be played by financial policies, but an increase in the export orientation of our economy will require changes in the pattern of investment and production. This, in turn, will have implications for the needed level of imports--production inputs, investment goods, and new technologies. The economy is characterized by high import intensity in export-oriented branches and a relatively high elasticity of total imports with respect to changes in aggregate output that, in the past, has been about 1.4-1.5. Thus, given our industrial structure, any

increase in exports--especially in such industries as electro engineering and chemicals--would necessitate an increase in imports, including imports of investment goods. In the circumstances, there is no possibility of effecting import reductions without deep structural changes in our economy, which can only be successfully introduced over an extended period.

Owing to the current imbalances in our economy and the difficulties of restoring equilibrium, the ability of enterprises to adapt to changing demand conditions, both at home and in foreign markets, has been limited. Technical factors, including inadequate managerial skills and the concentration of export production in a relatively small number of enterprises, have further added to these difficulties. In view of these factors, constraints on domestic demand by themselves are likely to have little or no effect on export performance.

I would stress that the authorities are as critical as the staff report as regards performance in 1985 and early 1986. Taking a realistic view of our prospects, it must, however, be realized that we are not in a position, by our own efforts, to solve the problems posed by the level of our indebtedness in convertible currencies by 1990. In the draft Five-Year Plan for the period 1986-90 we have provisionally targeted a trade surplus in convertible currencies of $1.2-1.3 billion. This figure is not, however, to be regarded as unchangeable. Rather, it reflects a realistic assessment of our trade prospects as they appear at the present time. We very much desire to achieve better results and, if external conditions allow, we believe that this will be possible. Moreover, in embarking on a further stage of economic reform, we shall shortly be introducing a range of measures which we believe will make a significant positive contribution to an improved trade and current account performance. It should be noted though, that precise quantification of the effect of these measures, which have only recently been decided on and which in some cases can only be implemented over an extended period, is not possible at the present stage.

Specifically, the measures that we intend to take include:

- Starting in 1987, fundamental adjustment of the price structure concentrating on increases in the prices of basic production inputs.

- Reduction in the scope of central allocation of production inputs and finished goods.

- Reduction in subsidies, which we hope by 1990 to have reduced to one fourth of their present level.

- Achievement of balance in the state budget starting in 1987.

- Movement to an equilibrium exchange rate for the zloty that will build on the exchange rate changes already introduced this year and that will facilitate a reduction in budgetary subsidies on foreign trade.

- Reduction in the pressure of household demand by limiting the growth of wages.

- Reduction in the pressure of demand from the enterprise sector by recuding subsidies, tightening policies on bank credit, and increasing the share of enterprises' financial needs that are to be met from their own resources. This should in turn permit a reduction in the role of central allocation of materials.

I believe that the adoption of these measures shows that, despite the difficulties it is facing, the Government is determined to take the necessary steps to achieve the desired changes in the structure and efficiency of our economy.

In sum, the essence of the policy issue facing the Government concerns the need to improve the efficiency of our economy to permit the living standards of the Polish population to rise with the strengthening of the external financial position. At the heart of our approach to this issue is the program of economic reform--some of whose main elements I have already described--that is now about to enter a second stage. We are fully conscious of the difficulties that this program will face. It will entail far-reaching changes in economic policies, in basic economic parameters, and in the way of achieving our objectives. To succeed will require a change in deeply ingrained attitudes. None of the steps will be easy to implement and it will all take time--time for the necessary measures to be implemented and time for these measures to take effect. In embarking on this stage of our reforms we look forward to close cooperation with the Fund and trust that in the period ahead we will be able to benefit from its support, both technical and financial.

Mr. Péterfalvy made the following statement:

I welcome the discussion of the Article IV consultation with Poland, the first one with the country in many years. The reintegration of Poland into the two specialized agencies of the UN, the Fund, and the World Bank will certainly permit the international financial community to obtain a better knowledge of the underlying economic processes of this major European country, and to find a long-term solution to the problems in the framework of a continuing policy dialogue with the authorities. I hope that this dialogue will lead to a viable balance of payments position in Poland on the basis of a comprehensive adjustment of the national economy.

I am more or less in agreement with the staff report and its appraisal of the economy. Therefore, I would like to elaborate on some general issues concerning the forthcoming policy dialogue with the authorities.

It is imperative that we recognize Poland as a centrally planned economy that has committed itself to implementing a comprehensive reform of its economic management system. This economic reform process is aimed at introducing and making use of market instruments to facilitate the long-term solution of the country's economic problems and to increase the export orientation of the economy.

By now, the Fund has had some experience with other "reform-minded" centrally planned economies that, compared with Poland at present, are more advanced with their reforms and enjoy more favorable economic conditions. Our experience has shown that this economic reform process may be rather painful and that there are social forces--vested interests in the centrally planned economies--that may temporarily slow down or counteract needed reforms. But this experience should not discourage us; rather, we should commit ourselves to facilitating these reforms and, if needed, we should even be ready to take sides with representatives of the reform ideas.

It is also very important that we have a clear view of the reform measures needed to achieve the desired goals. I think that the Board seminar on centrally planned economies (Seminar 86/3 and 86/4, 2/28/86) was very useful in identifying the priorities. But that seminar, as we recall, was and should be considered as only the first step in understanding the complexity of centrally planned economies. In this respect, I agree completely with the statements of Mr. Nguyen and Mr. Yang made during the recent Board discussion on Romania (EBM/86/167, 10/10/86) that further research is needed, perhaps to be followed up by Board seminars, to increase the quality of our approach to the problems of these countries, especially if our approach is intended to be a dynamic one.

The most important features of any reform are the comprehensive implementation of reform measures in every important sphere of economic activities, the avoidance of the continuing coexistence of the market-oriented economy and the command economy, and the necessity of embedding the required demand management measures into the reform process.

If we recognize that Poland has committed itself to implementing a comprehensive reform of its economic management system, any future Fund program should be based on facilitating that reform. It should be pointed out that the objective of embarking on a reform process is to ensure an economic performance conducive to a viable situation.

Consequently, in any future stand-by agreement with Poland the performance criteria must be shaped in such a way that it may be able to expedite the needed systemic reforms. I am not implying that the usual demand management measures should not be used. On the contrary, the soft budget constraints so characteristic of centrally planned economies must be dealt with as soon as possible, but performance at the same time should be geared to introducing--or even forcing out--institutional changes and, if needed, restricting demand on the basis of these institutional changes. We must be very innovative and flexible. We should not even be concerned about using a different set of performance criteria for a group of countries. This group of countries is so different that without making proper distinction, the Romanian case may repeat itself.

I have expressed my broad agreement with the staff report because I feel that the staff approach is more or less in line with the above-mentioned considerations.

The "interrelated measures" described in the staff report combined with others such as the reform of the financial intermediation--including the fiscal system, the banking system, the creation of a capital market among others--could serve as the basis for a future stand-by arrangement.

I also share the staff's view that "any set of indirect macroeconomic policy measures would be unlikely to yield the desired results unless there is a strong commitment by the Government to implement them." But at this stage I do not see any sign that the Government would be unwilling to implement such measures. What I see is a light in the unfortunately long Polish tunnel. I wish the authorities and the staff well in their long and intellectually interesting dialogue.

Mrs. Ploix made the following statement:

The revival of consultations with Poland is welcome because, as clearly expressed by the staff, the progress achieved by Poland in 1982-84 toward renewing growth while restoring a sustainable external position has faltered recently. My authorities thus welcome the re-establishment of the dialogue between Poland and the Fund. It is a key channel for international cooperation, mutual understanding, and assistance.

I would also like to thank the staff for its very interesting report. We know that the missions conducted prior to the readmission of Poland as a member of the Fund paved the way for this Article IV consultation report; but we also know that more has been done recently, and I would like to express my warm appreciation for the work presented here.

It does not seem necessary today to dwell at length either on past developments in the economy or on its relationship with other countries. I prefer to focus my comments on the future and to take this opportunity to examine the probable developments the economy is now facing and the reforms the authorities will have to implement.

On the whole, my authorities share the thrust of the staff's conclusions. We welcome the measures taken three years ago that were aimed at correcting the imbalances in the economy. Nevertheless, this effort has lost its momentum, and, as a consequence, prior successes in some areas like price deregulation or efficient resource allocation have been endangered. The present situation is a source of deep concern, and it is necessary for the authorities--as emphasized by the staff--to take decisive measures with a view to increasing production levels.

In our opinion, the emphasis should be put on developing production through increased productivity, decentralization, and greater autonomy for enterprises. If such measures are implemented together with a rigorous fiscal policy, they could lead to an increase in exports, which is badly needed. I agree with the staff that "the potential growth of the economy would be higher if it were export-led." Furthermore, and perhaps even more importantly, it is necessary to relaunch economic reforms in order to motivate all economic partners.

Thus, I welcome the set of measures described by Mr. Dorosz in his opening statement. Indeed, adjustment of the price structure of basic productive inputs, decentralization of the allocative mechanism of inputs, and reduction of subsidies are all measures aimed at facilitating more efficient allocation of resources and ensuring a sustainable increase in competitiveness for exports.

This aim, which is a mere revival of the objectives of the 1983 reforms, has to be firmly and constantly pursued. In this respect, the other measures considered by the authorities, such as the reduction in demand pressure both from the household and the enterprise sectors, and a flexible management of the exchange rate, will be of great help. Therefore, I welcome the decision implemented on September 1 as a useful step in the right direction;

however, it will have to be supplemented, as noted by the staff, by other important measures in the area of external economic relations.

As stressed by Mr. Dorosz, the measures decided upon by the authorities will require far-reaching changes in economic policies and deep-rooted habits. The success of the measures depends on full and tenacious implementation because, as developments during the past 18 months have illustrated, it is unfortunately easy to return to previous behavior, thereby endangering the successes that were achieved with difficulty. Furthermore, the success of such a policy change can be secured only if the various measures are backed up by a broader, comprehensive economic program.

The timing of the implementation of such a comprehensive program is uncertain, especially as it appears that some of the measures have only recently been decided upon.

We understand that a large number of the measures can be implemented only over an extended period. Any additional information Mr. Dorosz could provide on this point would be welcome. It is certainly up to the authorities to appraise the desirable pace of implementation, given the sociological and social constraints they face. Nevertheless, one cannot but keep in mind that the implementation of a strong program is already overdue. The present gap in Polish external financing is very serious because the commercial banks have refused to provide new money until a stand-by arrangement with the Fund is concluded. In the meantime, the accumulation of arrears to public creditors is particularly worrisome.

All these developments can be reversed only by pursuing the efforts already under way, and by demonstrating a firm and orthodox commitment, through the rapid establishment of a vigorous comprehensive economic program. My authorities are pleased to provide the Polish authorities with the utmost support in the difficult task ahead.

Mr. Wijnholds made the following statement:

I am very pleased that we are able to have this discussion of the Polish economy today, quite soon after Poland's return to the Fund. I would like to welcome Mr. Dorosz and the other members of the Polish delegation and to thank Mr. Dorosz for his interesting opening statement. The staff has produced an excellent report that in a concise yet comprehensive manner provides insight into the functioning of this unique economy. I will center my remarks on the medium-term outlook for the economy. Like the staff, I believe that the issues to concentrate on today are the economic policies to be followed by Poland in the medium term, which is also the time frame that is relevant when assessing the possible use of Fund resources.

I would like to begin by echoing a point made by the staff in its appraisal. The Fund's experience with centrally planned economies that are in the process of introducing market-oriented reform measures is indeed limited. The experience we have had so far is mainly based on countries that have implemented Fund-supported adjustment programs, and those programs have produced somewhat mixed results. While often in some areas considerable progress has occurred, particularly on the external side, in other areas hardly any improvement has been made. Generally, the overall improvement has probably been rather less than expected. One of the reasons for the limited success of these efforts might be that within the social and political context of centrally planned economies there always will be some degree of central control, and in some sectors this control might be more strongly felt than in others. It would be unrealistic, I believe, to plead for full liberalization and for a full play of market forces in these economies. Indeed, it is not our task to ask countries to act against their social and political priorities. At the same time, it is important to realize that the existence of a different level of central control according to different sectors of the economy tends to greatly complicate economic management. For instance, how are the central planners to ensure that sufficient resources are generated in the market sector to guarantee plan-consistent inputs in the socialized sector? Will liberalization in one sector not bring more sharply to light the inefficiencies in other sectors, which will then make the authorities very hesitant in pursuing further liberalization? It would seem to me that ensuring a consistent set of flows of goods and services is a daunting task for the authorities. Moreover, introducing market-oriented reform measures in these economies will tend to be a gradual process because the authorities will want to gain experience with the effects of such reforms.

However, based on our limited experience with this process--and like the staff, I would like to stress our still incomplete understanding of centrally planned economies--a few conclusions, of particular relevance to Poland, can be drawn. First, it is unrealistic to expect sustained rapid changes. While there might be some initial rapid improvement in some sectors, if production adjusts to the new circumstances new bottlenecks may soon arise. Thus, we should not be too ambitious in our expectations with regard to possible improvements in the Polish economy in the short run. Indeed, as Mr. Dorosz observes in his opening statement, economic reform in Poland will require change in deeply ingrained attitudes, and achieving this change will take time.

Second, improvements will only come about if the authorities are fully committed to implementing the needed reform measures. They must be willing to face the often unpopular temporary consequences that such measures are bound to have. The staff report convincingly argues that unless the pace of introducing reforms is sustained, improvements will at best be limited.

Third, close monitoring is of the essence. In this respect, I fully subscribe to the staff's argument in the second paragraph of page 22 of its report, where it warns against the inflationary dangers. Indeed, introducing more market-related prices and correcting price distortions generally brings about an increase in the overall price level. As a one-time correction process, this is acceptable and in fact inevitable, but care should be taken that an inflationary mechanism is not set in motion which could prove to be very hard to control.

Fourth, the industrial sectors in centrally planned economies often contain many monopolistic or oligopolistic features, which might make it more difficult to correct fully price distortions or to have a full play of market forces. Therefore, I believe that some degree of central planning and of price controls might continue to be warranted for as long as such monopolistic elements remain important. The primary concern should be to ensure that prices, particularly of tradables, are not out of line with world market prices and that central allocations do not override financial incentives.

I fully agree with the staff's analysis that by following a more export-oriented adjustment policy, the economy can improve quite considerably over the next few years. Indeed, it would seem that what appears to be one of the major aims of the authorities' medium-term plan, namely, to increase the supply of consumer goods for the domestic market, can be attained more efficiently by such an export-led adjustment effort. By expanding exports to the convertible currency area, the country might be able to import more from that area, which then might lead to an increase in efficiency and to the reduction of a number of supply bottlenecks that are now present in the economy. Moreover, the results of the Government's plan in the external sector--increased current account deficits and no improvement in the various debt service indicators--do not seem compatible with Poland's position as a large debtor country and would appear hardly acceptable to the country's external creditors. In order to achieve a return to some degree of creditworthiness, it is essential that Poland achieve at least a modest surplus on its current account in coming years. Like the staff, I see an urgent need for Poland to increase its exports to the convertible currency area, since the alternative of a drastic containment of imports is undesirable.

A first element in an export-led growth strategy, as indicated by the staff, must indeed be a restoration of adequate incentives for exporters. A further devaluation of the zloty can help to bring this about. I found the staff's comparison of producer prices for domestic and foreign production quite helpful. The normal measures of competitiveness, such as the real effective exchange rate, might be biased because consumer prices in Poland still contain important elements of subsidization and may thus not be fully comparable with those abroad.

A second element will be to bring prices of tradables more in line with world market prices, to limit domestic absorption, and to increase the share of goods available for exports. In line with such price reform, it would seem necessary to review the country's investment program. As I understand it, the bulk of investment scheduled for the coming year will be for projects initiated during the past few years. With a change in relative prices, those projects might no longer be economically viable and, once completed, could accentuate the inefficiencies of the past or give rise to new distortions. Because Poland has also joined the World Bank, it might be worthwhile for the Bank to investigate Poland's investment program. The staff could comment on the Bank's activities in Poland.

The restoration of adequate producer prices is of particular relevance to agriculture. According to the background paper, the agricultural sector in Poland was liberalized extensively over the past year and now operates without central control. Partly due to good weather, production has subsequently increased sharply. Nevertheless, production and value added have remained essentially flat over the past two years, or have even decreased somewhat for reasons that are not fully made clear. As a result, there still is a small deficit in agricultural trade, whereas at the beginning of the 1970s--before reforms were introduced--Poland had a small surplus in such trade. I wonder, therefore, whether there is not more scope to expand agricultural production and increase import substitution and exports. In this respect, it is worth noting that producer prices in this sector over the past few years generally have lagged behind other producer prices, as well as behind the general increases in prices, suggesting that they as yet might not be at a sufficiently remunerative level. Perhaps the staff can offer a comment on this aspect.

I would like to emphasize that pursuing sufficiently tight financial policies will be an essential ingredient of any adjustment effort. This will be important in preventing undercutting of the correction of price distortions by an increase in the general price level. In this context, credit policy can play a much more independent role than it does at present. While it might be true that some tightening has occurred recently, the persistent tendency of investment to overshoot planned levels seems to indicate that much more needs to be done in this area. In this respect, I agree with the staff that an increase in interest rates would be helpful. It should also be clear that wage developments should be watched closely and the link between wages and productivity be made as close as possible. Failure to do so would obviously risk generating inflation.

The staff outlines an ambitious reform program. This program seems as yet not fully in line with the authorities' own and perhaps too modest and rather pessimistic medium-term plan. However, the staff's approach seems to offer important benefits for the economy. At the same time, it has to be recognized that the effects of a number of measures are uncertain, with regard to the internal as well as external balance. As I have indicated, the essential measures of an adjustment program appear to be an increase in the incentives for exporters, an increase in the prices of tradables to world market levels, and tight financial policies, as well as moderate wage increases to counter inflationary pressures. In my view, if a Fund-supported program for Poland were to be negotiated, it need not contain a host of microeconomic performance criteria, but should concentrate on the macroeconomic elements I have just enumerated. Obviously, access to Fund resources would have to reflect the degree of adjustment and of the uncertainties involved.

Mr. Lankester made the following statement:

I should like to begin by welcoming the Polish representatives present today and by hoping that regular representation of Poland in a constituency at this Board can be secured soon. Poland's renewed membership of the Fund and the World Bank is a potentially key step in its search for a viable economic strategy for the future. My authorities consider that the Fund's expertise and--if appropriate policies are followed--its financial resources can be important catalysts for successful development.

However, for the Fund to play a suitable role, there has to be present the will to face up to the challenges that the necessary adjustment efforts will involve. I take Mr. Dorosz's opening statement as a real sign that the will is there, although in several important respects it still has to be translated into positive action. I hope that today's debate will further help to focus discussion in Poland and in particular make clear the urgency of the situation. My own intervention is framed with this end in view. This aim is helped by an excellent set of staff papers that are based quite clearly on commendably extensive statistical and analytical help from the authorities. More importantly to Western eyes, these data appear to have rather fewer inconsistencies and holes than data provided by some East European states. This helps to lay to rest the inevitable concern that members of the Board and Fund staff must have in approaching what is to them a new economy, one of a type with which the Fund has had less than optimal experience.

The staff report shows that, in a far from easy external climate, Poland has made some headway in the 1980s, but not enough to establish a viable basis for dealing with either its Western or Eastern bloc creditors. As far as Poland's current account position in convertible currencies is concerned, the deficit as a percent of GDP has fallen from 5.5 percent in 1981 to 0.8 percent in 1985. But the adjustment effort has slowed in recent years and according to the official forecast, the 1986 projection estimates the same deficit as a percent of GDP as in 1985. More worrisome is the fact that not only has the volume of non-ruble exports declined significantly this year, but the official projection for the period to 1990 is for a continuing current account deficit. In our view, the viability of this outcome is highly questionable. At the least, a modest but sustained surplus appears a necessary if not by itself a sufficient condition to restore creditor confidence and ease Poland's present very tight liquidity position.

The current account balance in nonconvertible currencies offers no comfort. The deficit last year was slightly greater than for convertible currencies. We are unable to judge whether and for how long this deficit is sustainable. If the deficit with the nonconvertible currency countries is to be reduced, as appears to be the authorities' aim, this must not be done in a way which interferes with Poland's efforts to boost its convertible currency exports.

It is clear that Poland must put more resources into exports; otherwise the already very difficult external position will become worse. Official creditors cannot be expected to help if they see arrears mounting on existing arrangements. Neither they nor the banks will act unless policies are in place that carry the promise of a significant improvement before long in the external position. We urge Poland to view its arrears to official creditors as a matter of great concern and to recognize that a greater effort to increase the resources going to exports has to be made.

In the short run, higher exports are likely to require lower domestic absorption. Indeed, the necessity for this shift of resources is underlined in the supplement to the staff report, which suggests that domestic incomes were rising quite rapidly in real terms and very rapidly in nominal terms. It is not difficult to see the link between these developments and other parts of the current scenario, including the accelerating price inflation and the falling level of non-ruble exports. If the comment, "more resources into exports" is not to mean less resources for domestic consumption in both the short and the long term, then Poland must recapture the commitment to structural change that was evident in the early 1980s. This commitment must then quickly lead to a coherent adjustment policy to achieve the goals which the Polish authorities have themselves repeatedly endorsed in recent years.

Since I fully support the recommendations in the staff appraisal, I do not need to spell out in detail the form of the program that we believe the Polish authorities should adopt. However, its key elements would undoubtedly be

- a rapid move to an equilibrium exchange rate;

- rapid freeing of domestic prices that together with the move to an equilibrium exchange rate could quickly eliminate many of the distortions and biases currently apparent in the use of resources;

- greater financial discipline. In the financial sector, this must involve much higher interest rates relative to price inflation; it must also require moving away from systems in which taxation and financial discipline upon producers is the result of their bilateral negotiations with the Government rather than working through of a general system with the minimum of exemptions and special cases.

Such policies will inevitably run into opposition both from vested producer interests and from consumers. We believe that opposition from the producers has to be outfaced: opposition from consumers can be eased by appropriate compensation closely targeted on the poorest groups affected. This can be done in a manner fully consistent with the further improvement in the fiscal position that the authorities are rightly seeking.

I welcome the proposed adjustment measures set out in Mr. Dorosz's opening statement, but I would urge an acceleration or front-loading of the proposed pace of change to make possible the achievement of higher but necessary targets for the convertible currency current account in the next few years. I would also note that it is crucial that new measures, such as in the field of pricing policy, do not suffer the fate of their predecessors in 1981/82. Reforms, once begun, must be continued, if possible according to a previously announced schedule so that the population can come quickly to accept that the Government means what it says.

The tasks ahead may seem daunting but they are necessary. Delay will only compound the problems. If they can be tackled effectively, then I believe that could provide the basis for a support package from the Fund and the Bank before too long. My authorities wish the authorities well in their endeavors.

Mr. Leonard made the following statement:

I welcome the opportunity to comment on economic developments in Poland. I also welcome the valuable statement provided by Mr. Dorosz, particularly the commitment by the authorities to provide comprehensive data to the Fund on a regular basis, for inclusion in the International Financial Statistics and for other purposes.

Generally speaking, I endorse the staff's analysis and I encourage the authorities to pay close attention to the staff's recommendations. In doing so, I would like to highlight a number of areas.

The medium-term prospects for the economy, particularly on the external account, are not favorable and suggest that there is an urgent need for Poland to undertake comprehensive adjustment on a number of fronts. The weakening of the trade balance, especially the fall-off in the volume of exports, in 1985 and 1986 is of concern and underscores the need for serious commitment on the part of the authorities to prevent further deterioration in the external account. Action toward that end must allow for greater market determination in the allocation of resources within the domestic and external sectors of the economy so that improvements in the balance of payments can be brought about with minimum impact on domestic absorption. In this connection, I agree with the staff that targets in the draft Five-Year Plan that imply no improvement in the trade surplus in convertible currencies, and a possible widening in the current account deficit, do not augur well for the balanced development of the economy.

By aiming vigorously for export-led growth, Poland would be able not only to alleviate its external imbalances, but also to improve the quality of its capital stock through modernization. The series of devaluations of the zloty over the past one and a half years and the general pursuit of an active exchange rate policy should indeed be helpful in encouraging exports, but as indicated by the recent trend of exports, they do not appear to have sufficiently improved the profitability of exports compared with production for domestic market. Therefore, I would urge the authorities to take action to improve the profitability of exports by following the staff's advice for a further sizable depreciation of the zloty, accompanied by a dismantling of the equalization system and a rationalization of the present complex and unstable array of nonexchange rate incentives to export.

At the same time, if the adjustment effort is to succeed, the quality of exports of manufactured goods will have to increase substantially and will require the import of equipment and technology, which may not be possible unless western and other financial agents are convinced of Poland's clear commitment to export-led adjustment. I note, as does the staff, that there appears to be ample scope for increased exports, given that Poland contributes a very small proportion of the world's non-ruble exports, has lost its market share in recent years, and at present devotes only a very small proportion of its GDP to exports.

Clearly, success in the external position will be dependent on appropriate domestic policies. In this context, there is an urgent need for a continued and rapid movement toward a market-oriented pricing system to alleviate the misalignment of relative prices. Difficult though it may be, this movement will also have to be complemented by a progressively diminishing role for the central allocation of goods.

As to the overhang of domestic liquidity, I endorse the staff's position on the need for tighter fiscal policy and the desirability of raising real interest rates. Such actions would have the effect of encouraging savings and reducing excess consumer demand and, more generally, would help to limit the potential inflationary effects of needed price adjustments. They would also act to tighten financial discipline on the part of enterprises, which itself should be further strengthened by phasing out preferential credits and extrabudgetary funding, partly in an effort to discourage excessive accumulation of inventories. More generally, greater institutional and administrative autonomy should be granted to enterprises in order to enhance their ability to respond to changing conditions.

My welcome of Mr. Dorosz's opening address stems partly from the fact that the authorities appear to be well apprised of the importance of the policy measures that the staff discusses in its report and that I have just mentioned. There is, however, a curious aspect about Mr. Dorosz's statement in that the authorities, while intending to undertake a considerable package of appropriate adjustment measures as outlined in paragraph 5 of the statement, do not expect any improvement in the convertible currency trade balance from the present levels. In this connection, I appreciate what may simply be prudent conservatism in the Polish forecasts. However, I also believe that the expected performance is probably not sufficient to avoid continuing external difficulties and unsatisfactory domestic growth and I am concerned lest the authorities' projections be due to an expected adjustment effort that is not sufficiently wholehearted. In other words, it would appear that the resolution of the apparent conflict between the recognition of the needed policies and expected results is the pace and/or degree of adjustment. Indeed, some of the measures outlined in paragraph 5 of the statement seem to suggest this. For instance, I wonder if Mr. Dorosz or the staff could inform the Board whether the authorities have prepared, or are preparing, a schedule for the implementation of the proposed reforms. If there is such a timetable I would encourage the authorities to make it public. Also, I wonder if Mr. Dorosz would provide us with more information on detailed, quantified measures that pay greater attention to the timing of policy changes.

I am sympathetic to the need to pay attention to the impact of economic adjustment on the political and social fabric. Indeed, I think that this is a problem that we perhaps might spend more time reflecting upon at the Fund, perhaps initially in the coming discussion on the theoretical aspects of the design of Fund-assisted programs. However, it seems clear in Poland's case that a gradual approach would not be sufficiently timely and wide ranging to achieve the results that the economy must achieve. Failure to act resolutely and vigorously is likely to decrease the probability of a successful adjustment by allowing existing constraints and inefficiencies to continue to inhibit economic performance and by diminishing the credibility of the adjustment in the view of Polish citizens and the international community. In particular, the latter effects are to be avoided in view of the importance of developing positive reinforcing expectations and actions on the part of both of these agents. Taking a more gradual approach also allows vested interests greater scope to derail adjustment efforts.

On previous occasions, this chair has advocated the importance of authorities taking steps to convince their public of the appropriateness of the adjustment measures. In the case of Poland, this seems especially important, and may be less difficult than envisioned, particularly if the liberalizing market effects of the adjustment effort is emphasized. In this connection, it would be important to target subsidies carefully to provide income assistance to the neediest groups both to enhance the credibility of the Government's effort and to facilitate a more radical approach to price realignments. I support the proposed decision and I would like to extend my best wishes to the authorities and join with Mr. Dorosz in looking forward to a beneficial association between Poland and the Fund.

Mr. Dallara made the following statement:

I would like to join other Directors in welcoming Vice Minister Dorosz, Professor Legatowicz, and Mr. Boniuk to this Board meeting. We believe that, at this early state of Poland's relationship with the Fund, the staff documents have usefully and properly focused on some basic structural problems of the economy and have taken a view of them in a medium-term framework. The initial framework for basic reforms was laid out in 1981-82. Although the framework for reform was a rather comprehensive one, actual implementation of reforms has been rather slow and, in some respects, spotty.

The staff report recognizes that in 1983-84 some progress was made in putting into place certain policies under this framework and, partly as a result of those reforms, in achieving higher economic growth, lower inflation, and a somewhat strengthened external position. We commend the authorities for the progress achieved. But the staff also reports that there has been a slowdown in economic performance in 1985-86 and that progress on reforms has been mixed. In addition to the slowdown, however, the way in which reforms have been introduced have tended to reduce their effectiveness. In addition, it should be noted that the favorable events in 1983-84 were in part due to factors that cannot be counted upon to produce similar results over the longer term. Reforms have tended to be introduced gradually and on a piecemeal basis, leaving some parts of the economy still functioning under the previous system of widespread direct intervention by the Government. Some policies that have been put into place, such as price decontrol, have been undercut by offsetting measures such as large wage increases. Financial policies have not always been supportive of structural reforms in recent years. For example, we note that a substantial part of credit continues to be directed to Government and to public enterprises without a clear test of economic efficiency. Similarly, nonfinancial considerations partly determine investment flows, and resources continue to be transferred through the budget in ways that appear to blur the link between efficiency and financial returns. These problems, which we understand the authorities are working hard to address, clearly undermine the effectiveness of the intended reforms.

One of the most important elements of the reform was to have been the liberalization of relative prices and a general deregulation of price controls and price adjustments of publicly provided goods, to allow relative prices of goods, labor, capital, and foreign exchange to serve a relatively more important allocative role. While a number of price adjustments have been made and some price controls relaxed, other important domestic prices have remained significantly below international prices. The fact that many domestic energy and material prices are well below international prices does foster material-intensive investment, rather than investment with a higher capital and technology content and with employment-creating potential that could help to reduce underemployment. Clearly, there is a need for more price deregulation measures.

Furthermore, the slow pace of removing obstacles to adjustments in relative prices as a means of resource allocation has impeded the efficient use of investment funds and economic growth. While some complementary measures have been taken to reduce the direct allocation of investment by the Government, such direct allocation of resources continues to be widespread, involving one fourth of industrial production. In this connection, as other Directors have pointed out, there is a large backlog of old investment projects, which continues to absorb resources for purposes that may not be economically viable. Perhaps, the World Bank would be able to play a useful role in reviewing investment priorities.

The dilemma faced by the authorities of needing to contain real wage costs and to tie them to productivity growth to permit wage differentiation, while facing pressures to extend the benefits of growth to the labor force in an equitable manner, is not unique to Poland. Many other countries face similar difficulties. As in other situations, the current policies are necessary if greater labor mobility is to contribute to better resource allocation. In our view, this underscores the need to involve the labor force actively in reaching a national consensus that recognizes that sustainable economic growth, the creation of productive employment, and the equitable sharing of income all depend on an improvement in the economic efficiency of the economy.

Greater economic efficiency will also be facilitated by greater capital mobility. Yet, the direct allocation of credit remains widespread, and the budget continues to be an important intermediary in allocating financial flows. In our view, if Poland is to achieve a higher level of sustainable growth and industrial modernization, together with improvement in external accounts, then a more decentralized mechanism for mobilizing domestic savings and allocating investment efficiently would need to be pursued. Therefore, we believe that financial markets need to be liberalized and real interest rates allowed to become positive in real terms.

Some progress has been made in reducing the intermediary role of the budget, with both the ratios of revenue and expenditure to GDP having fallen significantly since 1980. Yet, there remain significant discretionary transfers to enterprises in the form of subsidies and differential effective taxation. While some erosion of the tax base owing to tax exemptions and rebates is not uncommon among member countries, a general broadening of the tax base does seem appropriate in the Polish economy.

As to the external accounts, we agree with staff that the authorities' approach to strengthening the balance of payments and dealing with external debt over the medium term does not seem very ambitious and does raise a number of problems. In our view, this approach lends support to the argument for a more competitive exchange rate to help to assure export profitability. In this connection, data in the supplement to the staff report on trade developments earlier this year heightens the importance attached to the exchange rate and the need to stimulate exports. We recognize that there has already been some change in the rate, but more needs to be done. In this context, we believe that the equalization settlement system is counterproductive and inconsistent with the Government's balance of payments and economic reform aims. We believe that a major reform, if not the outright elimination of the system, appears needed.

The draft Five-Year Plan presents a medium-term balance of payments scenario in which Poland would, explicitly or implicitly, gradually achieve current account surpluses with the nonconvertible currency area, while accumulating growing current account deficits with the convertible currency area. We believe that this pattern of external balances would be undesirable for two reasons. First, the overall current account balance and foreign debt position would not improve sufficiently. For example, according to official projections, the debt service ratio would still be 86 percent in 1990. Second, we believe that countries in the convertible currency area would find it extremely difficult to accept Poland's objective of reducing its debt to the nonconvertible area at a time when the external deficits with the convertible currency countries are expected to grow, and against the background of requests for very substantial debt relief for Poland in recent years.

I would reiterate that I support the initial efforts that have been made by the authorities to reform their economy, as well as their determination to continue the reform effort. Nevertheless, the staff has offered some specific views as to the possible content of a more comprehensive and ambitious approach. Like Mr. Lankester, we would associate ourselves generally with these views, which are spelled out on pages 20-22 of the staff report. Yet the authorities have outlined a cautious and gradualist approach, and Mr. Dorosz acknowledges in his opening statement that the implementation of a comprehensive reform program will face difficulties and that far-reaching changes in economic policies will not be easy and will take time. The Fund itself has learned from practical experience the difficulties faced in bringing about a lasting transition from a rather comprehensive system of state planning to a more decentralized and more market-oriented system. Thus, in line with the authorities' views that the time will be required, we would expect the Fund's relationship with Poland also to evolve gradually and cautiously over time.

Mr. Lundstrom made the following statement:

I would like to join other Directors in welcoming Vice Minister Dorosz and his associates to this meeting on the occasion of the first Article IV consultation with Poland. I am in general agreement with the staff appraisal and recommendations, so I will limit myself to a few brief remarks.

It is clear that both the staff and the Executive Board are disadvantaged by the fact that the functioning of centrally planned economies is still fairly unfamiliar territory and lacks transparency.

Although I admire the effort made by the staff to bring such excellent papers before this meeting, it is clear that more insight into the functioning of these economies is needed. In addition to the continued efforts of the staff to this end, a better understanding can be acquired only through the full and active cooperation of the authorities with the staff during forthcoming consultations.

Poland now stands at a crossroads. Indeed, as Mr. Dorosz notes in his opening statement, Poland's system of economic management is in a period of transition. The authorities need to implement a comprehensive program encompassing demand management and structural reforms. The basic objectives of a Polish policy course must be to secure a viable external balance and to improve the allocation of resources in the economy. The staff report has laid out a course of action that I fully support. The four main policy ingredients are a sizable further depreciation of the zloty, major adjustments in domestic prices in order to improve the allocation of resources, a phasing out of the central allocation of goods pari passu with the realignment of prices, and tight budgetary, credit, and incomes policies.

I concur with the staff that these interrelated measures constitute a coherent adjustment program that could lay the basis for attaining the desired objectives. I am encouraged by the fact that, according to Mr. Dorosz's opening statement, the authorities envisage taking measures of this kind. But the timing and implementation of these measures have not been set out very clearly. Like some other Directors, I would appreciate any further information on this point from Mr. Dorosz or the staff. As the staff points out, it is also essential to subject enterprises to effective financial discipline and to ensure that they are allowed the necessary autonomy to adapt their real behavior to altered price signals.

More generally, it is necessary that reform of the economic system be carried out simultaneously in the domestic and the external sectors so that the measures are complementary. I believe that we have had experience with other centrally planned economies that would support this conclusion; here, I agree with most of Mr. Wijnholds's remarks. In this connection, experience also shows that it would be helpful if the political and ideological constraints, if any, that would hamper the implementation of the proposed type of adjustment measures in these economies were highlighted in future staff papers. I would also encourage the authorities to study carefully the experience gained from some other centrally planned economies that have moved toward liberalization in order to increase economic growth through an improved allocation of resources. It would seem clear that the necessary basis for a reform program of this kind is a flexible price system which would realistically reflect relative scarcities in the economy and generate resources through appropriate channels.

The task that the authorities face is clearly a formidable one. This is in no way concealed in the staff report, which is one of its many qualities. I wholeheartedly agree with the staff's observation that no measures would be likely to yield the results desired "unless there is a strong commitment by the Government to implement them" and that there is a strong expectation in Polish society that the comprehensive economic reforms that will be undertaken will in effect be conducive to those results. This is all the more important because price increases and real income reductions would seem to be unavoidable at the outset. Apparently, the authorities are fully conscious of this aspect of the implementation of their program. In his opening statement, Mr. Dorosz notes that for the economic reform to succeed "it will need to change deeply ingrained attitudes." This is an important observation.

I would encourage the authorities to cooperate actively with the staff, not the least by supplying them with all the necessary information so that Poland can benefit fully from the policy dialogue which has now been opened. The authorities might perhaps also be well advised to make use of the technical assistance provided by the Fund. I wish the authorities well in their endeavors.

Mr. Grosche made the following statement:

Let me start by welcoming Poland back into the folds of this institution. The Fund assembles countries with quite different economic systems. The constructive and cooperative spirit governing our organization should also be of great benefit to Poland at a time when its economy is facing very difficult problems.

Indeed, the staff papers for this discussion of the first Article IV consultation with Poland leave no doubt that the economy has not yet fully recovered from the crisis of 1981/82. Although the stabilization and reform program launched in 1982 produced a remarkable recovery, it appears that the more recent period has brought severe setbacks. Economic growth has slowed since 1984, domestic and external imbalances have widened again, and external debt continues to rise. The efforts to address the fundamental obstacles to sustained economic growth thus appear to have produced only limited success; renewed efforts are needed to overcome the country's difficult domestic and external problems.

The causes of the present economic difficulties are fully--and candidly--described in the staff report. They are also clearly acknowledged by the authorities. The authorities also seem to agree with the staff on many of the measures that are needed to tackle these problems.

The sociopolitical obstacles to the effective implementation of the measures can hardly be ignored. In a way, the authorities have responded to perceived problems by choosing a rather gradual path in the context of the new Five-Year Plan that they recognize is likely to achieve rather unsatisfactory results compared with the potential results of alternative policies. I believe that they also recognize that pursuing this path is not without risk. The rather bleak propects seem to have led the 10th Party Congress to re-examine economic policies with a view to achieving an acceleration of the economic reforms, which one hopes will lead to some important improvements. The information provided by Mr. Dorosz in his helpful opening statement is very encouraging in this regard.

In my view, the elements of an adjustment strategy outlined by the staff provide an appropriate basis on which the authorities could build in formulating policies to attain adequate growth and balance of payments viability over the medium term. Therefore, I am pleased to note that the list of measures that the authorities intend to take in the foreseeable future includes many of those elements.

First, one necessary prerequisite for an improvement of Poland's trade balance would be a further significant depreciation of the zloty. Such a move would enhance the possibilities of rationalizing the complex foreign trade system, characterized by many different export incentive schemes and various import restrictions. But we should also be aware that Poland's exports face challenges not only of price, but also one of product design, quality, and marketing.

Second, a more flexible exchange rate policy has to go hand in hand with policies that promote a shift of resources from domestic absorption to the external sector and enhance overall productivity in the economy. To achieve this, it would be of the essence to correct existing distortions in relative prices, to dismantle gradually the various administrative regulations and state interventions in the operation of enterprises, to phase out the central allocation of goods, and to subject enterprises to greater financial discipline.

Third, it would be important to set the price and exchange rate adjustments against a background of appropriate fiscal, monetary, and incomes policies that would check the expansion of domestic demand.

To be sure, the task faced by the Government is an extremely difficult one, and the efforts it is making are commendable. For example, the fiscal consolidation achieved in recent years is highly welcome. This quantitative improvement of the Government's financial situation should now be followed up by structural improvements in the budget. In this context, I would urge the authorities to pay particular attention to the reduction of subsidies, which still take up a rather high share of total expenditure. Prudent fiscal policies would have to be accompanied by sufficiently restrictive monetary policies in order to avoid an excessive supply of liquidity to the economy, and I agree with the staff that positive real interest rates could play an important role in this respect.

Incomes policy would have to ensure that the financial situation of individual enterprises as well as productivity trends are more adequately taken into consideration in granting pay increases.

I agree fully with Mr. Dorosz that increased export orientation would require significant changes in the pattern of investment and production. It is true that the needed modernization of Poland's productive base would over time necessitate an increase in imports, especially of investment goods and technology. But an efficient redirection of existing domestic and external resources away from uneconomical projects and into more productive activities would seem at least as important, given the present constraints on available foreign financing.

In sum, I agree that the comprehensive set of policies outlined by the staff holds the promise of bringing the economy onto a more sustainable growth path while reducing the existing external imbalances. As scenario 2B in the staff report demonstrates, better results can be achieved if appropriate policies are implemented fully in a timely manner. By following a policy course along the lines assumed in that scenario, the Government could also enhance the prospects for a normalization of the country's financial relations with its trading partners. In the short run, Poland's creditworthiness would be considerably improved if the arrears under the 1981 and 1985 Paris Club rescheduling agreements could be reduced substantially, which would also enhance Poland's possibilities of receiving further debt relief.

I associate myself with the excellent staff appraisal and support the proposed decision. I would like to extend our sincere wishes to the authorities for succcess in their endeavors.

Mr. Sengupta made the following statement:

I would like to welcome Poland and convey this chair's best wishes on the occasion of Poland's first Article IV consultation with the Fund. The comprehensive staff reports indicate that the authorities should be complimented for the extensive data that they have made available for the preparation of these reports. The staff should also be complimented for the excellent job it has done in putting together the data and analyzing it in a detailed manner. I would also like to compliment Mr. Dorosz for his excellent and informative opening statement, which has enabled us to improve our understanding of the economy.

After a continuous rapid expansion in the first half of the 1970s, the economy experienced difficulties in sustaining its growth momentum and controlling external debt problems. Economic growth revived in 1983-84 with the growth rate at about 5.8 percent. However, the experience since 1985 has not been very satisfactory. The rebound of production from its earlier dislocation tapered off, and capacity constraints hampered additional prospects for coal, the major export commodity. The severe winter of 1985 also diverted exportable coal to domestic consumption. The volume of convertible currency exports fell by 4 percent while imports rose by 11 percent in 1985. With better terms of trade in volume terms, the deterioration of trade balance was smaller and the current account deficit fell by more than half to 0.75 percent of GDP. However, with negligible capital inflows and substantial loan repayments, debt relief was required for the fifth consecutive year. Trade performance continued to be weak in the first half of 1986. For 1986 as a whole, even after some import restrictions and debt relief by official creditors and banks, the overall deficit in the external account is expected to be about $600-700 million. At the end of 1985, Poland had an external debt of about $30 billion, equivalent to 42.2 percent of GDP, and the debt service ratio was as high as 81 percent before debt relief.

The objectives of the authorities' strategy for remedying the situation and returning the economy to a more favorable position are contained in the provisional plan for 1986-90. These policy objectives are quite sound. We agree that restoring equilibrium on domestic markets is a prerequisite for the effective functioning of a reformed economic system and that modernizing and restructuring the economy are a precondition for achieving a faster growth in output and exports. The estimated rate of growth of output for this period is low because of supply constraints, declining quality of capital stock, and shortage of foreign exchange essential for restructuring and modernizing production. The current account deficit is expected to grow to about $1 billion by the end of the plan, and debt service ratios would continue to average the high rate of about 75 percent of exports of goods and services. The staff seems to believe that the projected current account deficit of $1 billion by the end of 1990 is unsustainable.

The most important question one needs to address is that, given the moderate growth objectives of the plan, is it possible to reduce the current account deficit further without sacrificing efficiency and longer-term sustainability of the economy? The medium-term scenarios developed by the staff in Appendix III of its report provide some insights but, as is always the case with such scenarios based on a variety of assumptions, they need to be interpreted with great caution. The staff's recommendations are predictable: a sizable depreciation of the zloty; dismantling of the equilization settlements system; adjustment or increase in prices of producers goods; removal of subsidies; tightening of budgetary credit and incomes policies; and phasing out of central allocation of goods. These are standard recommendations, but in fairness we should note that the staff also recognizes that the implementation of these policies could result in a short-run loss in growth and an increase in prices.

It is clear from Mr. Dorosz's opening statement that the authorities are well aware of the problems confronting the economy and the need to take adequate adjustment measures to return the economy to a sustainable growth path. Clearly, the main issue is the precise timing of these policies and the scale of policy action in order to avoid too rapid a change, which would precipitate spiraling inflation, social discontent, and disruptions in the fiscal management of public enterprises. The optimal speed of adjustment would depend on an assessment of these factors to be made mainly by the authorities, keeping in view the external financing constraints and the need for achieving reasonable economic growth. Some of the indicators contained in the staff report suggest that the growth objectives of the provisional plan are on the low side, but even to achieve these would call for continued sacrifices on the part of the Polish people. It should be noted that the real net material product of Poland in 1985 was only 88.4 percent of its level in 1978, per capita consumption was 94.9 percent, and gross fixed investment only 70.8 percent. All these would indicate an imperative need for growth and investment. The provisional plan targets are modest, as evidenced by the fact that even at the end of 1990, the net material product would barely reach the level of 1978.

Poland has embarked on a broadly based economic policy reform with increased market orientation of several sectors of its economy, and it would need both time and resources to carry through these reforms without undue disruption, given the limitations it faces in export capacity and the weak technological base of its manufacturing sector. While it would be necessary for Poland to follow sound macroeconomic policies and implement appropriate structural policies as recognized in the plan and outlined so clearly in Mr. Dorosz's opening statement, the international community has a special responsibility to help Poland adequately in its gigantic task of reshaping its economy at this critical juncture. The policies outlined for implementation are very impressive and without too much scrutiny could have entitled Poland for Fund assistance immediately. Help from the international community would include ensuring adequate net resource flows into Poland over the next few years through increased debt relief from official and private creditors, increased assistance from multilateral institutions, and the opening up of industrial country markets to Poland's exports. Actions along these lines would enable Poland to adopt policies boldly and in a sustained manner for it to achieve long-term viability. In the absence of a generous and nondogmatic response from the international community, Poland could be forced to withdraw into options that would lead to a more regulatory and closed economy, with all its consequences. I hope that this will not be allowed to happen.

I would like to congratulate the Polish authorities for their courageous endeavors and convey the best wishes of this chair to them for their success.

Mr. Fujino made the following statement:

Like previous speakers, I welcome the return of Poland as a member of this important international institution. Through the continuous and extensive exchange of views between the Fund and the Polish authorities, there could emerge a common understanding and recognition of the issues and the necessary policy measures.

I appreciate the high quality of the staff report, which clearly analyzes the situation and identifies the difficulties. I basically endorse the staff appraisal. I have also benefited from Mr. Dorosz's very candid opening statement.

The serious debt problems, the weakening external position, and domestic disturbances at the start of the 1980s prompted the authorities to take measures of short-term adjustment and stabilization. The net material product plunged by more than 17 percent in two years from 1981 and consumer prices rose by 100 percent in 1982. At the same time, the authorities addressed the basic difficulties of the economy through the design of a fundamental reform of the economic system. The reform, which envisaged a major shift in the direction of decentralization of the decision making and greater use of indirect policy instruments, has been embodied in legislation as a permanent structure of the economy.

In view of the apparent distortions in the economy--a rigid price structure, the low profitability of enterprises, and a complicated decision-making process--this reform was a courageous move in the right direction. The authorities should be commended on launching such a far-reaching and fundamental reform.

In 1983, as the net material product began to recover, the rate of inflation became more moderate, and the current account deficits on convertible currencies were considerably reduced. The current pace of progress, however, seems to be much slower than expected. The projection of the external position for the period 1987-90 seems to imply a widening of the convertible current account deficits from $560 million in 1986 to close to $1 billion in 1990. The amount to be externally financed in 1990 would reach over $5 billion. This worsening prospect of the external position will be detrimental in retaining creditor confidence and securing necessary support from the international financial community.

I strongly agree with the staff's concern that a significantly more rapid growth in convertible currency exports than currently targeted is attainable with the concerted efforts being made toward this end. As the staff points out, the analysis of external trade is complicated by the difficulty of making a unified evaluation of transactions both in nonconvertible and convertible currencies. A more structured approach to foreign trade would help the efficient use of resources. The exchange rate policy would certainly be an important condition for achieving a better export performance. The recent reversal of an early appreciation is a helpful development, and the two depreciations during this year amounting to over 30 percent is a welcome step; however, further sizable measures are needed to streamline the exchange system and improve the competitiveness of exports. A closer link between the domestic and external prices would increase the incentives for export or decrease the demand for imports including foodstuffs.

The staff provides a very useful framework of analysis by providing four alternative scenarios of economic prospects to 1990. This strongly suggests the need to strengthen policy reform in the direction already envisaged in order to attain a sustainable external position with an adequate rate of growth of the economy. It is encouraging to note in Mr. Dorosz's statement that comprehensive policy measures including measures affecting the price structure, subsidies, and the exchange rate would be shortly introduced, and I expect that these measures will be put into effect in an expeditious way. A sufficiently tight financial policy would be a necessary prerequisite to carrying out the comprehensive reform program without creating inflationary pressure in the economy.

The removal of price rigidity is an essential element of the reform. This is well recognized by the authorities. Mr. Dorosz's statement emphasizes the vital role of the price system in the economy. The introduction of a market-based price system in the form of contract prices is a welcome development. The fact that these prices are becoming increasingly more regulated, however, seems to indicate the difficulty and limit of the reform now being carried out.

Subsidies, which account for 45 percent of the current budgetary outlays, are another indication of accumulated distortions in the economy. Subsidies, once introduced, tend to proliferate and grow larger in any type of economy. From the viewpoint of reducing the budget deficits, a reduction of subsidies is an essential step.

This is the first candid review of the policies now being undertaken by the authorities, and I hope that they will give adequate consideration to the views expressed at the Executive Board today.

Mr. Huang made the following statement:

I welcome Mr. Dorosz and the other Polish representatives who are attending the Executive Board meeting this morning.

I am in broad agreement with the staff's comprehensive report, which provides a precise and constructive analysis of Poland's economic developments since the early 1970s and emphasizes the analysis of its economic adjustments.

I am impressed by the authorities' efforts to promote economic modernization, especially those economic reforms aimed at a substantial decentralization of decision-making power from government to enterprise, and the considerable use of economic levers instead of command planning. Although the authorities have faced a difficult situation caused by various factors, their efforts and their achievements in economic development and reform in the past several years are commendable and clearly merit our attention and support.

A major problem appears to be the deterioration in trade performance that has led to a considerable increase in external deficits and debts. The staff has urged the authorities to pursue a concerted export-led adjustment aimed at reversing the movement of the current account into surplus, and has also provided some policy suggestions. While I agree in general with the staff's analyses and suggestions, I would like to stress that greater reliance on further depreciation would not produce the satisfactory effects anticipated, because, owing to structural issues, it might not contribute much to the improvement of export performance and the balance of payments position. On the contrary, further depreciation may contribute to a greater increase in the external imbalance owing to a substantial increase in import costs. I think that it would be more important to provide more financial incentives for export activities in order to avoid sizable leaks of export goods into the domestic market. To this end, a realignment of prices or reforms in pricing, banking, and foreign exchange management might be needed.

I appreciate Mr. Dorosz's excellent opening statement and fully agree with his judgment that the solution of Poland's domestic and external economic problems lies in a substantial increase in economic growth, which can only be achieved through an increase in economic efficiency, an export orientation, and participation in the international division of labor. It is clear that the realization of these three objectives will necessitate a fundamental reform in economic management and a substantial adjustment in economic structure. I am glad to learn that the authorities have committed themselves to these programs in the coming years, and I believe that any progress in these programs would contribute greatly to improving the performance in economic efficiency, economic growth, and external balance. I also believe that the persistent efforts of the authorities to implement economic reform and structural adjustment can count on the Fund and other institutions for technical and financial support. I wish the authorities success in achieving their economic goals.

Mr. de la Herrán made the following statement:

We would like to join previous speakers in welcoming Poland back to this institution and this Board. We would also like to thank Mr. Dorosz and his colleagues for their presence here today. The main conclusion that I drew from the staff report is that thus far the economic system prevailing in Poland has not yielded the desired results and that a number of imbalances and inefficiencies have arisen partly as a consequence of the decision-making process. In other words, steps toward more market-oriented techniques seem to be indispensable. In their endeavor, the authorities must make a crucial choice as to whether they desire a prompt introduction of the reforms or whether the speed of the necessary changes should be more gradual.

The major constraint for the authorities is the precarious situation of the external sector and the growing debt that not only threatens the fulfillment of external obligations by building up additional arrears, but also absorbs a great part of available convertible currency. Apparently, the composition of exports is such that inputs for this sector are clearly import intensive. Such dependency on imports to develop the export sector certainly implies additional strain on the need to obtain foreign currency and exacerbates the dilemma of servicing the debt in compliance with the stipulated terms or maintaining the necessary volume of imports.

The different paths suggested by the alternative scenarios presented by the staff show that no viable solution can be achieved without profound reforms on almost all fronts. In this regard, an export-oriented strategy would seem to be the appropriate framework in order to galvanize the reforms already started. Mr. Dorosz has clearly pointed out the views of his authorities in his opening statement.

The caution of the authorities in dismantling a complicated system, including subsidies, incentives, and distorted prices, is perfectly understandable, particularly if they still do not have a managerial infrastructure that could rapidly reorient the activities of enterprises toward more market-based schedules.

We would not like to enter into more details of how such a strategy should be launched. The staff report has pointed out the main weaknesses of the economy and contains a first approach to what should be done in the first instance to redress the deteriorating situation, particularly the external sector. Such steps, as Mr. Dorosz puts it, will entail far-reaching changes and will take time because, among other things, those changes are inevitably associated with social costs.

The most important factor now is that Poland has realized the seriousness of the situation and has accepted the need to embark on a thorough reform of the economy.

Certainly, becoming a member of the Fund implies obligations, but it also entails benefits from the support of the institution.

A request from the authorities to negotiate a program with the Fund would be a natural initiative under present circumstances. That would be the appropriate time to discuss more in depth the details of the reform, the degree of adjustment that the authorities are willing to undertake, and the amount of financial support that such program would deserve. In this connection, we share the views expressed by Mr. Wijnholds that a future program will be more consistent if it concentrates on macroeconomic aspects. We would like to wish Poland a fruitful and constructive relationship with the Fund. We support the proposed decision.

Mr. Zecchini made the following statement:

This is the first Article IV consultation with Poland. We take this opportunity to welcome the return of Poland to the Fund and to express our hope that a long period of fruitful cooperation between this country and our institution has thus begun.

We read with interest the concise and comprehensive statement of Mr. Dorosz, and it is comforting to note that the authorities share many of the staff's concerns and are planning to take a number of corrective measures. In general, we endorse the staff's analysis and its main recommendations; therefore, I will concentrate my remarks on what I consider the few basic points of an adjustment strategy that takes into account the dire difficulties that the economy is still facing.

In this respect, it must be acknowledged that, as in the case of other centrally planned economies, the knowledge we have of the workings of these economies is still less than full. Therefore, it is with some caution that we approach these policy issues, although it is reassuring to note that our knowledge could be enhanced in the future by building on the commitment of the authorities to provide comprehensive economic and financial data on a regular basis.

During the 1980s, Poland was faced with a prolonged period of economic difficulties that the authorities attempted to ease by intoducing a program of economic reforms and by tightening financial policies. However, in the past two years, as recognized by the authorities, progress in the implementation of planned reforms and strategy has fallen short of what had been originally expected, and the economic difficulties have become more acute.

The persistence of a long series of balance of payment deficits that have inflated the external debt beyond manageable proportions shows how the need for external equilibrium still constrains the policy strategy and the possibilities for sustained economic growth. As pointed out by Mr. Dorosz, recognition of the urgency of eliminating this constraint can also be found in the relatively high elasticity of imports to changes in aggregate output. However, it is fair to say that weaknesses in economic management as well as the economic structure play an equally important part in constraining economic growth and delaying economic development.

In line with this diagnosis, we believe that the best policy approach to external as well as internal economic adjustment should consist of an appropriate mix of measures aimed at reducing domestic absorption and at encouraging expenditure switching. The latter should be directed toward more efficient use of resources, a strengthening and expansion of the export sector, and development of the financial superstructure of the economy. Expenditure switching should encompass measures related both to the management of the business cycle and to structural changes in economic mechanisms.

A reduction in the rate of increase of domestic absorption below that of the increase in production is necessary in order to free resources for the export sector. In this respect, policies in 1985 and in the first part of 1986 do not appear to have been fully successful, since the real income of the population appears to have increased at a high pace due to increases in real wages. These tendencies have been confirmed by the latest data reported in Supplement 1 of the staff report. A tighter incomes policy would therefore appear to be of the essence and it should be implemented in part by creating stronger incentives for enterprises to resist excessive wage demands. In this respect, one of the instruments that has been used by the authorities has been a steeply progressive levy on wage increases that exceed productivity, the PFAZ. However, this levy has encountered operational difficulties. The staff reports that receipts from the PFAZ in 1985 fell considerably short of what might have been expected by developments in the wage sector. Moreover, fiscal disincentives may not have been sufficient, since enterprises were allowed to translate cost increases into price rises.

An excessive creation of liquidity has also bolstered domestic demand. It would appear advisable to reabsorb the excess liquidity now existing in the economy and to tighten financial policies in order to better pursue the objectives of external balance. We note from the first paragraph on page 6 of the staff report that the authorities plan to increase prices in order to reduce purchasing power and real cash balances. This action, however, addresses the symptoms rather than the causes of the imbalances and should be reconciled with other objectives, such as the improvement of external competitiveness through the depreciation of the real effective exchange rate.

Nevertheless, the compression of domestic absorption should not be indiscriminate, and in particular should not be at the expense of promoting fixed capital investment in those sectors that are or can be internationally competitive and which can offer good opportunities for a rapid expansion of exports.

At the same time, we welcome the increased attention that has been paid by the authorities to a reappraisal of investment projects begun in previous years, because an analysis of the opportunity costs involved in committing additional resources to them could lead to optimization in the use of the limited resources available.

The need to promote more profitable investment and more competitive exports leads us to comment briefly on expenditure-switching measures. At the core of these measures there should be a restructuring of the price system in order to make it more responsive to relative scarcities and less prone to arbitrary changes.

Such a system should also bring transparency into the panoply of incentives that are now aimed at creating comparative advantages in some sectors within the domestic production system. A transparent system for price setting could also offer more certainty of economic viability to production and investment units; once they are given more autonomy in their choices, those units will become more accountable for their decisions.

Obviously, prices also have a larger role to play in guiding consumption decisions. In this respect, it is unquestionable that a more rational price system has to be complemented by a system of subsidies limited to the neediest groups.

Exchange rate policy is an integral part of any price reform and any drive to reorient domestic production toward exports. We note that between 1981 and 1985, the profitability of producing for the export market has sharply deteriorated compared with the profitability that could be derived by selling in the domestic market. This is largely imputable to a sharp appreciation of the nominal exchange rate, not to mention the relative levels of subsidization implicit in pricing the same goods differently according to the markets where they are sold.

According to staff estimates, despite the two sizable depreciations in the exchange rate that have taken place in 1986, the ratio of domestic producer prices to export prices is still about one third higher in 1986 than in 1980-81. This seems to indicate that further realignments of the exchange rate are warranted and that flexibility should be retained in exchange rate policy in the coming years. This should go together with a corresponding scaling down of the policy of subsidization and the addition of more transparency to the system of apparent and less apparent subsidies.

The function of prices should also be reviewed to improve the financial structure and management of the economy. Undoubtedly, financial structure and management appear to be at a very early stage of development, because there is a very limited range of financial instruments and institutions, a rather subsidiary role for monetary and credit policies vis-à-vis the financing requirement of the economic plan, and extensive direct controls on credit allocation.

We believe that greater efforts have to be deployed to upgrade such a system. Specifically, interest rates should gradually replace existing administrative mechanisms and become the leading factor in stimulating financial savings to better regulate the liquidity conditions of the economy and to allocate credit on the basis of considerations on both relative scarcities and relative rates of return on the financeable projects. At the same time, greater diversification in issuing financial instruments would help channel more resources toward the most valuable uses. By the same token, and for reasons we have already spelled out in the Board discussion of the Yugoslav economy (EBM/86/134, 8/8/86), an involvement of nonfinancial enterprises in interenterprise credit as a result of a privileged access to credit sources should be discouraged.

Finally, a few words on two aspects where further work might be undertaken by the staff. First, in principle, the medium-term scenarios should provide a valuable base for assessing the likely results of present policy trends and for exploring the comparative advantage of alternative policy prescriptions. In the table in Appendix III of the staff report, several scenarios are described, together with their immediate macroeconomic assumptions. Nevertheless, it is not possible to relate any specific policy changes to the emergence of those developments which are the preconditions for the final results shown in the table. For instance, it is apparent that there are substantial differences between scenarios 1B and 2B, on the one hand, and the remaining scenarios, on the other, as far as domestic absorption and external debt are concerned. However, it is not clear what specific policy options should be considered in order to best induce these results, and what is the degree of feasibility of these policy changes or the degree of realism of the other exogenous assumptions.

Second, it is important not to overlook the fact that a substantial part of trade and financial relationships of Poland takes place with the COMECON countries. A more extensive analysis of these relationships is needed to put the examination of balance of payments developments and trends in a more appropriate perspective.

Mr. Alhaimus made the following statement:

I would like to join other Directors in welcoming this opportunity to discuss the first Article IV consultation with Poland. It is clear from the staff report that the 1981/82 reforms contributed to a substantial progress in the following years in restoring output growth and improving the external position. Real GDP, after a steep fall in 1981 and 1982, registered a relatively high rate of growth in the following two years, and the ratio of the current account deficit to GDP was also substantially cut in these two years. However, signs of difficulties began to surface again in 1985. The rate of output growth sharply decelerated and, on the external side, non-ruble exports fell and imports showed a large increase. Some adverse factors contributed to this deterioration: the severe winter; capacity constraints on coal production; and the weakening of Poland's Middle Eastern markets, reflecting the oil-related general retrenchment in that area.

Nevertheless, the staff also cites a number of important policy factors behind the recent failures, such as the absence of further measures to restructure prices, the easing of financial discipline, and the large decline in the profitability of production for exports. The combined effect of these factors is still affecting the current economic scene in 1986, as the supplement to the staff report confirms, and has clouded the prospects of the economy. In such circumstances, the authorities are confronted with the difficult task of economic revival at a time of persistent rigidities in the economic structure and deep financial constraints of a heavy debt burden.

As the staff report shows, the authorities have demonstrated a clear awareness of the basic difficulties of the economy, and Mr. Dorosz has reflected this in his clear and candid opening statement. The authorities' assessment of the complex problems seems to have led to the prevailing approach based on setting only modest targets. Indeed, the main policy objectives of the draft Five-Year Plan for 1986-90 are modest, and even somewhat pessimistic. An output growth of 3-3.5 percent is envisaged, which will restore the level of production in 1990 to a little above the 1978 level. However, even this rate is uncertain because, as the staff notes, it crucially depends on a 2 percent annual reduction of the ratio of energy and raw material consumption to output. Such a plan would also imply an increase in the present current account deficit over the period to 1990, which might mean, as the staff says, that Poland would continue to be crippled by its weak external financial position.

The alternative policy course that the staff suggests, based on a concerted export-led adjustment effort that might significantly alter the external outlook, does pose difficult problems but may offer a more sustainable alternative. The main problem with an export-led approach, as Mr. Dorosz reiterates in his opening statement, is the high import intensity in export-oriented sectors--an intensity which can only be moderated over an extended period. Thus, it may be observed that the costs of higher exports do not allow a realistic option, especially given the external financial constraints of Poland. The issue, however, is still whether the measures that the staff suggests--supported by adequate external financial backing, which Mr. Sengupta rightly emphasized--can offer Poland a better alternative.

It is encouraging to note that recently the authorities seem to have given support to the need to accelerate the implementation of economic reforms and to increase the export orientation of the economy. If this attitude prevails in the current debate on economic strategy in Poland, it might indeed provide a better hope for more satisfactory growth of the economy and can enhance confidence in the external prospects in the years ahead.

Mr. Romuáldez made the following statement:

This chair welcomes the reopening of the dialogue between the Fund and Poland. We believe that the Polish experience will contribute greatly to the Fund's understanding of the dynamics of centrally planned economies, and we are confident that Fund perspectives can prove useful in Poland's efforts to undertake structural reforms.

We agree fully with the staff on their appraisal of Poland's economic situation. We also endorse the staff's policy recommendations, which, although concisely drawn, are certainly comprehensively designed.

Like other Directors, we appreciate the inherent difficulties attendant on the reform of such centrally planned economies as that of Poland, where the basic assumptions and normal thrust of reforms are of necessity market related. In suggesting directions for reform we, like the authorities in implementing their reforms, find ourselves constantly faced with the conflicting demands of values that central planning is meant to preserve, on the one hand, and those to be gained through market orientation, on the other. In the final analysis, although we are aware that the authorities must themselves decide on the extent and speed of their reform efforts, we can only make the suggestion--which, on the basis of our all too limited understanding of centrally planned economies, we feel is appropriate--that the authorities should undertake the implementation of reforms more decisively and more steadily than they have hitherto done and build up a momentum adequate to the needs of an economy that continues to be buffeted by external and internal developments that threaten to diminish the effectivity and impact of reform measures.

In short, we would advise an implementation program less gradual than that which has been followed to date. We wish the authorities success in their efforts to improve the efficiency of their economy.

Mr. Abdallah made the following statement:

I am in broad agreement with the staff appraisal and wish to join other Directors in welcoming Mr. Dorosz. It is encouraging to note that Poland has recently taken some measures, albeit cautiously, to move away from the old model of rigid reliance on central decision making with respect to major economic variables such as output, exports, and prices, thereby giving enterprises greater autonomy. This has largely originated from the legislative, institutional, and policy changes that became the reform blueprint of 1982, the implementation of which brought about economic expansion that recorded an annual real GDP growth rate of 5.5 percent, particularly in the period 1983-84. That growth decelerated in 1985 and 1986, was due largely to exogenous factors, notably severe winter, deterioration in the terms of trade, and protectionism. Mr. Dorosz's helpful opening statement underlines the pervasive role of "external conditions" in Polish economic performance.

The authorities deserve encouragement for their commitment to implementing the economic reform measures highlighted by both Mr. Dorosz and the staff. The adjustment of price structure, if effectively implemented, could provide the price system a greater allocative role, resulting in enhanced efficiency in resource utilization. However, considering the resistance of strong vested interests and the fact that old customs and attitudes die hard, one can appreciate the slow progress in the effort to steer the economy from its traditional course. Thus, while we urge the authorities to persevere in their policy reform commitment, especially in granting greater autonomy to enterprises, there is also a need to introduce greater flexibility in economic management generally. I believe that, although the economic reform measures should be implemented vigorously, a less drastic approach preferred by the authorities might, in existing circumstances, be more realistic.

A serious weakness of the economic mechanism that the authorities must address fairly urgently is the inconsistency between wages and productivity policies. Although aspects of the labor market operation can be explained by egalitarian values of Polish society, the need to provide incentives to higher productivity and control wage costs cannot be overemphasized. I welcome the current steps taken to decentralize the wage determination process in order to free the enterprises from the rigid national wage arrangements. It is hoped that individual enterprises would evolve flexible wage structures that are consistent with productivity. The existing practice of imposing a progressive levy on wage increases that are not matched by increases in productivity may be useful, particularly in a nonmarket-oriented system. But that is not enough. A way must be found to adequately reward individual performance and effectively motivate labor.

I share the views expressed by the staff that an export orientation of the economy is crucial to growth and to the solution of the country's debt and balance of payments problems. I note that the authorities themselves fully recognize this fact, although they see the particular structure of the industry--a structure characterized by high import intensity in export-oriented areas--as constituting a serious problem to export promotion. Nevertheless, I urge them to initiate necessary structural changes that will facilitate export orientation of the economy.

In a situation where prices do not play a key role in signaling disequilibrium, one tends to sympathize with the staff in some of the policy prescriptions for rapid export growth described on page 20 of the staff report. Indeed, without complementary measures to rationalize the numerous nonexchange rate incentives to export, the recent changes in the exchange rate of the zloty may be less effective as a policy aimed at encouraging exports. Therefore, priority must be given to improving the profitability of exports relative to that of producing for the domestic markets for 1986-90 while focusing on the restoration of equilibrium on domestic markets, takes a rather static view of export possibilities. I would urge the authorities to do everything they can to eliminate the imbalances by greater concentration on exports.

In our limited experience with the centrally planned system where the verdict of the market is seldom as final as in other economies, especially in the short run, it is necessary to recognize that we do not know enough about how to reform this type of economy. Therefore, Fund staff must be prepared to learn from the experience of other centrally planned economies which are performing much better than Poland to see what lessons may usefully be applied to this country. I support the proposed decision.

The staff representative from the European Department said that the World Bank was building up its economic work on Poland and that a Bank mission was about to visit the country to focus on the investment program and on ways of increasing the export orientation of the economy. The mission would also seek to evaluate Poland's creditworthiness and areas for possible project assistance in future lending activities. Fund staff would participate in the Bank mission in the same way that Bank staff had participated in recent Fund visits to Poland. In passing, he noted that the level of per capita income in Poland was not a bar to its ability to borrow from the Bank.

The recent stagnation in the agricultural outlook should be seen against the background of unprecedented growth in 1982 through 1984 that had resulted from a sharp adjustment in procurement prices, improvements in other incentives, and extremely good weather, the staff representative continued. It had been inevitable that the rate of growth would taper off at some point. The staff did not believe that the recent slowdown could be attributed in a major way to a weakening of price incentives. The Government was committed to a policy of income parity between the sectors. In the short run, procurement prices in agriculture might lag behind comparable increases in the industrial sector, but in addition to the price paid to producers, the other tool used by the Government was input subsidies, which had generally been modified to compensate for slow adjustments in prices.

There was undoubtedly scope for the agricultural sector to increase production and contribute more to improving the current account position, the staff representative remarked. Productivity in agriculture in Poland was low compared with not only Western European countries, but also many other countries in Eastern Europe. The agricultural sector was characterized by substantial subsidies and price distortions, as well as by overemployment. There were also structural problems, such as the small average size of farms.

The four medium-term scenarios presented in the staff report did not represent fully specified programs, the staff representative observed. The objective had been to make a first attempt to define different possible combinations of targets to illustrate the possible trade-offs and the possible implications for key macroeconomic aggregates, and in the process elicit reactions both from the authorities and the Board. The staff hoped to develop the alternatives in the light of the reactions to them and to explore the policy trade-offs further.

At the time of the staff visit to Poland, the timing, pace, and implementation of the new policy measures were issues that had been under very active discussion within the Government itself, the staff representative commented. There had been different views, particularly regarding the appropriate pace of reforms and the targets for output and exports. Those who argued with the staff for moving more rapidly with more ambitious targets for exports saw considerable scope for raising the rate of output growth through more efficient utilization of resources; the large efficiency reserve in the current wasteful utilization of resources and the record of energy and materials used over the past years was indicative of the potential available. It also had to be recognized that it was necessary to look beyond 1990. There was a clear need to position the economy during the current period to meet the external financing burdens that would come due in the early 1990s. The majority of Poland's debt had been rescheduled to that period and would increase at that time.

The staff representative from the Exchange and Trade Relations Department said that he wished to reassure the Board that the medium-term scenarios were not meant to be projections and were not in any way binding on the staff or the authorities. At the consultation stage, it was very difficult to take a definite stand because policies had not yet been specified and the trade-off, for example, between exchange policies and other measures that the authorities might take, could not be specified by the staff. Hence, establishing a linkage to specific policies would be premature at that stage. In addition, an incomplete understanding of a planned economy such as Poland's made those linkages very difficult to specify.

Mr. Dorosz said that economic reform in Poland had come at a time that could be regarded as unsatisfactory for undertaking such significant measures. Unsatisfactory conditions prevailed both within and outside the country. The economic reforms had changed basic legal arrangements in the economy and had decentralized decision making in order to bring about a better reallocation of resources and to establish greater openness of the economy. Certainly, it was debatable whether the results had brought about a large enough shift; in the opinion of his authorities, many of the results had been substantial and, in view of the various bottlenecks prevailing at the time, it would be difficult to expect much more. Nonetheless, his authorities did believe that the overall results had not been promising enough.

The basic commitment of his Government to pursue economic reforms had been clearly stated in 1983, Mr. Dorosz continued. Although he could not deny that there had been some setbacks in the implementation of reform in 1985, the slowness of the implementation could have been attributable not only to internal factors, but also to some extent to external factors. Since their efforts had not resulted in significant material external support, it was natural that the authorities would have some hesitancy in implementing the policy at a faster rate.

The Five-Year Plan for 1986-90 was based on realistic assumptions, Mr. Dorosz remarked. During the past decade, there had been a great tendency in Poland to build up plans that were very optimistic and had targets very difficult to fulfill. His authorities had devised a plan that could be regarded as realistic, taking into account the present conditions of the economy. Nonetheless, it was true that the plan could be regarded as unsatisfactory by themselves and outside observers of the economy. However, there had been some rethinking, and another attempt had been made to remodel economic policy to provide a greater impetus to the economy and thereby bring about greater structural changes. The elements of the Five-Year Plan had now been prepared, and a detailed program had been prepared for 1987 that had been built into the budgetary plan and that would entail substantial changes in the price structure. One of the major changes would be an increase in the price of coal. Since coal was the country's major energy source and thus one of the most important elements of the price system, the increase in price would be substantial for industrial end-users and would mean that the price would come closer to what could be regarded as the international price of coal. Other price changes had been undertaken in basic raw materials owing to changes in prices in international markets and the depreciation of the zloty. Further changes would be undertaken and would provide better signals to the enterprises; those changes would probably speed up the adaptability of enterprises and decrease their utilization of basic commodities.

The second important element of the financial plan for 1987 was the substantial decrease of budgetary subsidies, Mr. Dorosz went on. The authorities aimed to have a balanced budget in the coming year, which implied that the real value of budgetary subsidies would decrease by about 20 percent. That action could bring a major change in conditions under which many of the enterprises were working.

In 1986, there had been two devaluations of the zloty, Mr. Dorosz said. In the circumstances, the devaluation of the zloty could provide greater profitability for export-oriented enterprises and could restabilize the interest in allocating production toward foreign markets.

It was very difficult for the authorities to evaluate qualitatively the measures which would be introduced in 1987 because they had not had much experience with economic instruments, Mr. Dorosz considered. It would be very difficult to judge the response of the economy to a real depreciation of the currency and the effect of decreasing subsidies on the allocation process. Countries that had been utilizing economic instruments of management for some time could develop econometric models that would provide better direction on the results that such policy implementation could bring about. Nonetheless, even with considerable experience and good statistical data on the behavior of the economy, there was still great uncertainty built into any forecasting process. For that reason, he believed that it was appropriate not to say that the planned targets could be changed substantially. However, the aim was to have a more active policy and to have a greater adjustment process if possible.

The possibility of bringing about equilibrium in Poland was a difficult question, Mr. Dorosz remarked. During the 1980s, Poland had tried to establish a substantial balance of trade surplus with western economies. Indeed, during the mid-1980s, Poland had reached a volume of trade with the western economies that was comparable to the volume it had had in the late 1970s. With varying economic conditions and outputs, prices had changed and, thus, the value of exports had decreased. However, imports had fallen by 40 percent. Poland's economic development would depend very much on imports of essential inputs. If greater export activity was to be undertaken, it could not be done without greater imports. There should be further discussion on the proportion of production in 1987 that could be designated for exports and the value of the trade surplus. Currently, it could be argued that the size of the export trade surplus within the economy was quite substantial. If the so-called tight export revenues were deducted from the overall export revenues of the country, it could be seen that Poland devoted almost 30 percent of its export revenues for net servicing of outstanding debt, which was a significant achievement. Further research should be undertaken on the potential level of export decrease and the determination of the size of the trade surplus.

The issue of Poland being unable to improve its position vis-à-vis the COMECON countries because of inadequate improvement in its external position with respect to the western countries was very delicate, Mr. Dorosz observed. In the 1980s, Poland's net material outflow to western countries resulting from a surplus in the trade accounts had been facilitated to some extent by the net material inflow from COMECON countries to Poland, which implied that Poland had built up substantial indebtedness to the COMECON countries. Further discussion should be undertaken on the appropriate strategy for balancing indebtedness toward both groups of countries without endangering Poland's development prospects.

His authorities had recognized the problems of the economy and had indicated their desire for improvement, Mr. Dorosz noted. Poland desired greater cooperation with the Fund and he hoped the institution would support the country's endeavors for improvement.

The Acting Chairman made the following summing up:

Executive Directors welcomed the opportunity to review economic developments and policies in Poland on the occasion of the first Article IV consultation and looked forward to a close and productive relationship with the Government of Poland. Directors noted the partial recovery in Poland's economic performance since the period of severe dislocation in the early 1980s and welcomed the restoration of output growth and the reduction in the current account deficit in convertible currencies over the past three years. There was agreement that the recovery had lost momentum in 1985 and 1986 and that the adjustment effort had weakened. In that connection, some Directors noted that there were external factors that had contributed to the loss in momentum. Thus, the external financial position remained untenably weak and the basis for maintaining a satisfactory rate of growth in domestic output was not, under present policies, in place. The urgency of these concerns was underscored by the perceptible deterioration, since 1984, in: the performance of exports to the convertible area; the rate of growth of output; and the balance between demand and supply in the economy. Against this background, Directors were generally of the view that a sustained and comprehensive adjustment effort, aimed both at improving the efficiency of the Polish economy and at a major strengthening of the balance of payments, would be necessary in order to lay the basis for more rapid and sustainable growth and a durable improvement in living standards.

Seen from that standpoint, the pace of the current account adjustment foreseen in the authorities' preliminary medium-term plans was viewed by Directors as inadequate, and the pattern of external balances vis-à-vis the convertible and the nonconvertible currency areas as projected in the Five-Year Plan was seen as undesirable. Moreover, the slow growth in the volume of exports--and consequently, imports--underlying these plans was likely to hamper severely the needed restructuring of the economy. Directors noted that a substantially faster pace of external adjustment would be possible with a relatively modest diversion of resources from domestic use. They strongly urged the authorities to adopt bolder export and current account targets.

Directors were generally of the view that the objective of restoring Poland's creditworthiness and easing the extremely burdensome level of external debt would require both a rapid movement of the convertible current account from a deficit to a significant surplus--with maintenance of the latter for some years--and the elimination of the growing volume of external payments arrears. Only under these circumstances, several Directors emphasized, would official and private creditors be willing to consider resuming capital flows to Poland.

As regards the policies to be pursued in order to achieve the above aims, Directors generally endorsed the specific suggestions set out in the staff appraisal. They welcomed the indication provided by the Polish representative that the authorities' views were similar to those of the staff, and that they were committed to carrying forward economic reforms aimed at improving efficiency through the adoption of a more decentralized and market-oriented economic system. There was, in the view of all speakers, both a pressing need and considerable scope for increasing the effectiveness with which raw material inputs, labor, and capital were used. Directors were encouraged that a new stage in the reform process was now about to begin and they welcomed the indications given by the Polish representative regarding the broad outline of the measures that the authorities intended to take in the short run. Doubts were expressed, however, as to whether the measures contemplated promised to go far enough, and many speakers felt that more precise quantification of policy objectives and the specification of the timetable and the means by which they were to be achieved would be necessary if the authorities' revised plans were to be seen as plausible and attainable.

It was generally stressed by Directors that an essential step in improving the efficiency of the Polish economy would be the elimination of the multiple price distortions. Price reforms aimed at improving the pattern of resource use would permit the release of resources for strengthening the balance of payments at a lesser cost to the level of domestic absorption, while at the same time raising the possible sustainable rate of output growth over the medium term.

Particular emphasis was given by most speakers to the need for a realistic exchange rate. Recent exchange rate adjustments had not thus far been either large or timely enough to offset the negative effects on export incentives of relatively rapid increases in prices and buoyant demand on the domestic market. More generally, it was felt that exchange rate policy should be much more ambitious, with the aim of substantially improving the profitability of exports and eliminating the need for a range of supplementary and less efficient incentives. Such a policy would also contribute to a more effective structure of scarce imports. Directors also commented negatively on other price distortions, in particular the continued heavy subsidization of energy use in relation to international prices and lagged adjustments in agricultural producer prices.

Directors emphasized that if price reform measures were to achieve their intended effect it would be essential that they be complemented by tight constraints on the growth of aggregate domestic demand in order to free the necessary resources for net exports and also to prevent inflation from eroding the effect of price changes. In gauging the degree of demand restraint that would be required, allowance would need to be made for the existing excess liquidity in the economy, particularly in the household sector. In that context, many speakers stressed the importance of wage restraint in limiting the growth of demand in the household sector. The stated objectives of the authorities to balance the state budget as of 1987 and to proceed with rapid reductions in budget subsidies were welcomed by Directors. In that connection, Directors encouraged the authorities to target any remaining subsidies for the benefit of the needy. Most Directors urged the authorities to take account of the role which positive real interest rates could play not only as a means for improving the allocation of scarce financial resources, but also for providing incentives for savings.

Directors noted that traditional adjustment policies would need to be complemented by measures to ensure that enterprises had both sufficient incentive and leeway to respond to changes in the pattern of relative prices and demand. The imposition of effective financial discipline on the enterprise sector would be an essential prerequisite. This was seen as having policy implications in several areas and, in particular, requiring: further reductions in subsidies; a streamlining of the system of enterprise taxation including the abolition of discretionary and ad hoc tax reliefs; and much greater attention to economic criteria in the allocation of credit. To provide enterprises with the freedom to respond to altered price signals, Directors saw a reduction in the scope of administrative intervention in the allocation of resources as imperative. The authorities were encouraged to review the efficiency and productivity of existing investments and it was suggested that the assistance of the World Bank could be helpful in that connection.

Directors recognized that the implementation of a coherent adjustment program might need to proceed in stages but were generally of the view that bold steps were warranted initially if they were to carry conviction both domestically and abroad. The interrelatedness of the necessary measures, meanwhile, argued strongly in favor of a comprehensive approach along the lines sketched out in the staff report and the appraisal. Several Directors stressed that such an approach would need to be supported by external financing and by open markets in Poland's major trading partners.

It is expected that the next Article IV consultation with Poland will take place on the standard 12-month cycle.

The Executive Board then took the following decision:

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

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

Decision No. 8421-(86/169), adopted
October 15, 1986

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/168 (10/10/86) and EBM/86/169 (10/15/86).

2. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND REPRESENTATION

The Executive Board approves Fund representation at the consultations with the CONTRACTING PARTIES to the GATT on India, Korea, Nigeria, and Yugoslavia, to be held in Geneva, October 14-15, 1986, as set forth in EBD/86/269 (10/9/86).

Adopted October 10, 1986

3. EXECUTIVE DIRECTORS - SECRETARIAL AND CLERICAL ASSISTANTS - GRADING; AND DISTRIBUTION OF SET-ASIDE AMOUNTS TO ADVISORS AND ASSISTANTS

1. Secretarial and Clerical Assistants shall be provisionally graded as follows:

(a) Those Secretarial and Clerical Assistants who are currently at Ranges B, C, D, and E shall be graded at the corresponding grades in the new salary scale, Grades A4, A5, A6, and A7, respectively. Those Secretarial Assistants who are currently at Range F and have served less than five years at this range shall be graded at Grade A9 while those who have served for more than five years at this range shall be graded at A10. Secretarial Assistants will be subject to the same grandfathering provisions as apply to staff members whose positions have been downgraded.

(b) Clerical Assistants who are at Range A shall be graded at Grade A3 if they have less than two years of service, or at Grade A4 if they have two or more years of service. Secretaries who are at Range B shall be graded at Grade A4.

(c) In determining the provisional grades for Secretarial and Clerical Assistants, length of service shall be calculated from September 1, 1986 and the effective date of the provisional grades shall be deemed to have been January 1, 1986.

(d) The provisional grades, while providing a basis for the distribution of the set-aside amounts and the 1986 merit increase, shall be subject to review and possible adjustment following decisions to be taken concerning the overall system for grading and salary progression for these positions which is currently under review. Any necessary adjustments shall be made at the time the new system is implemented and shall be retroactive to January 1, 1986.

(e) Secretarial and Clerical Assistants shall receive distribution from the amounts set aside on the occasions of the 1984 and 1985 compensation reviews, in accordance with the provisions set forth in the Executive Board Decision taken on January 30, 1986 (EBAP/85/312, Sup. 2, 2/4/86).

2. Assistants to Executive Directors shall receive distribution from the amounts set aside on the occasions of the 1984 and 1985 compensation reviews, in accordance with the provisions set forth in the Executive Board Decision taken on January 30, 1986 (EBAP/85/312, Sup. 2, 2/4/86) for staff members who "held grade."

3. Advisors to Executive Directors who immediately prior to their appointments served as Assistants to Executive Directors or as staff members shall receive distribution of set-aside amounts in respect of the period of that service to which such distributions are applicable. (EBAP/86/238, 10/7/86)

Adopted October 10, 1986

Mr. Dallara registered an objection to the above decision, as set forth in EBAP/86/238, Supplement 1 (10/14/86).

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAP/86/241 (10/9/86) and EBAP/86/242 (10/10/86) is approved.

APPROVED: June 15, 1987

LEO VAN HOUTVEN
Secretary