

OECD ECONOMIC SURVEYS

POLAND

1997

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1996-1997

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Table of contents

Assessment and recommendations 1

I. Macroeconomic policies, performance and prospects 13

Export and investment-driven growth 13
Persistence of high unemployment 22
Inflation, indexation and capital inflows 26
Fiscal management 36
The current situation, short-term prospects and risks 45

II. A new economy and some enduring features 54

Political and administrative background 54
Supply, demand and price shifts 57
Privatisation and commercialisation 65
Banks and enterprises 73

III. Coping with human costs in the transition and beyond 84

Inequalities and poverty 84
Unemployment 94
Social safety net 102

IV. Convergence in the longer run 117

Macroeconomic convergence 117
Structural realignments 122

Notes 136

Bibliography 144

Annexes

I. Agriculture 147
II. Unrecorded exports 152
III. Hidden employment and unemployment 156
IV. Mass privatisation 159
V. Chronology of main economic events and policy measures 163
VI. Statistical tables 171

Tables

Text

1. *Strategy for Poland:* Macroeconomic framework 15
2. Growth of value-added by sector 16
3. Contributions to growth 18
4. General government revenues, expenditures and balance 37
5. Arrears on taxes and social security contributions 41
6. Structure of domestic marketable government debt 44
7. Summary of outcomes and projections 50
8. Progress of ownership transfer 67
9. Public sector enterprises 72
10. Market shares of main groups of banks 74
11. Indicators of banks' health and performance 76
12. Results of the law on financial restructuring of enterprises and banks 78
13. Hard coal: performance indicators 80
14. Alternative measures of poverty 91
15. Incidence of relative poverty 93
16. Standards of living of the long-term poor 94
17. Physionomy of unemployment 96
18. Regional unemployment dispersion 98
19. Selected social benefits 103
20. Finances of the main social security funds 104
21. Health 111
22. Import tariffs 125

23. Border posts and crossings 127
24. Selected environmental indicators 132

Annexes

A1. Agricultural indicators 148
A2. Unrecorded exports indicators 153
A3. Enterprises included in the MPP 161
A4. Output of major products 172
A5. Monetary survey 173
A6. Interest rates 174
A7. State budget 175
A8. Long-run evolution of consumer and producer prices 176
A9. Balance of payments 177
A10. Warsaw Stock Exchange: Equities market 179

Figures

Text

1. The take-off 14
2. Output: international comparison 14
3. Production in the main industrial sectors 17
4. Real exchange rates 20
5. Unemployment rates 24
6. Unemployment: international comparison 24
7. Registered unemployment: inflows and outflows 25
8. Inflation 27
9. Inflation: international comparison 28
10. Gross official foreign exchange reserves 31
11. Inflation and interest rates 32
12. Nominal exchange rate developments 33
13. Remonetisation and financial deepening 35
14. Fiscal indicators: state budget 38
15. Structure of state budget revenues 40
16. Industrial output 47

17. Sectoral shares in output and employment 58
18. Share of the private sector 60
19. Direction of foreign trade 62
20. Long-run price developments 64
21. Perceptions of transition 85
22. Income inequality 86
23. Long-run evolution of real incomes 88
24. Subjective evaluation by households of their material well-being 90
25. Regional unemployment rates 99
26. Unemployment rate and size of the local labour market 100
27. Wage stickiness and unemployment 101
28. Factors underlying pension expenditures 113
29. Openness to trade 124

BASIC STATISTICS OF THE REPUBLIC OF POLAND

(1995 unless noted)

THE LAND

Area (sq. km)	312 680
Arable land (in per cent of total area)	60

THE PEOPLE

Population (millions, mid-year)	38.6	Employment (millions)	15.3
Projected population growth rate, per annum (1996-2000)	0.2	Employment by sector (percentage of total)	
		Agriculture	26
Rural population (percentage of total)	38	Industry (including construction)	30
Life expectancy at birth: male	67.6	Services	44
female	76.4		
Infant mortality (per thousand)	13.6		

Registered unemployment (percentage of the labour force, mid-1996)	14.3
Labour force survey unemployment (percentage of the labour force, mid-1996)	12.4
Number of pensioners (millions)	9.1

PARLIAMENT

Bicameral Parliamentary system	
Sejm membership (lower house)	460
Senate membership (upper house)	100
Number of political parties in Sejm (elections of September 1993)	6
Share of seats in Sejm held by governing coalition (per cent)	65.9

PRODUCTION

GDP (billion news zlotys, current prices)	286
GDP per capita (US$, purchasing power parity exchange rate)	5 479
Gross fixed capital formation (percentage of GDP)	17

PUBLIC FINANCE

General government budget balance (percentage of GDP)	–1.8
General government revenues (percentage of GDP)	47.8
General government expenditures (percentage of GDP)	49.7
Public debt (end-year, percentage of GDP)	56.2

FOREIGN TRADE AND FINANCE

Exports of goods and services (percentage of GDP)	26
Imports of goods and services (percentage of GDP)	25
Gross international reserves (billion US$, mid-1996)	17.6
Gross external debt (billion US$, mid-1996)	43.0

CURRENCY

Monetary unit: zloty (redenominated in January 1995)		Currency units per US$ (fixing)	
		Average 1995	2.42
		Mid-October 1996	2.82

This Survey is based on the Secretariat's study prepared for the review of Poland by the Economic and Development Review Committee on 25th September 1996. It is published on the responsibility of the Secretary-General of the OECD.

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The previous Survey of Poland was issued in December 1994 .

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Poland was officially invited to join the OECD on 11th July 1996. Accession was in the process of ratification by the Polish authorities when this Survey went to press.

Assessment and recommendations

A soaring economy, but some structural challenges are still ahead

In many ways, Poland stands out as one of the most successful transition countries. A bold and comprehensive package of reforms was carried out early on, with effective external support. The recession was shorter and shallower than in neighbouring countries, and subsequent growth faster, as epitomised in the recently emerged metaphor of Poland as the ''soaring eagle of Europe''. Financial policies were tight enough to ensure gradual disinflation. Poland graduated from IMF stand-by conditionality in mid-1995 and was officially invited to join the OECD in July 1996. As evidenced by developments so far in 1996, the challenge is now to sustain vigorous growth and to move closer to financial stability, with a view to converge over time with western Europe. In that regard, the difficulty to push through some of the key structural reforms – at a time of buoyant growth – means that an opportunity may be missed and creates a risk for the future.

Vigorous growth can be sustained; tax reform will help

Real GDP overtook its peak pre-reform level in 1994-95 (depending on the series used), ahead of the other transition economies. Given that its composition had much improved in the meantime, the effective aggregate output loss was less than real GDP measures would suggest. This dynamism to a large extent reflects that of the private sector, including the grey economy, which has initially acted as a buffer, offering alternative jobs and incomes. However, as stressed in the medium-term programme *Strategy for*

Poland adopted in mid-1994, the shadow economy needs to be progressively integrated into the official one, which otherwise suffers from unfair competition. Successful businesses do have incentives to register, and are ready to pay taxes – not least to gain legal protection and access to financial and other inputs needed for further expansion. However, the rate of compliance with taxes and other duties is inversely related to the level of taxation and regulation. In this respect, the streamlining and reduction in corporate tax rates envisaged in the follow-up medium-term programme *Package 2000*, adopted in the spring of 1996, should help. More generally, the emphasis placed in both programmes on a leaner government should be growth-enhancing. The efforts to shift government expenditures from consumption to investment, visible in the 1996 and 1997 budgets, will work in the same direction.

Unemployment is slowly receding but may remain high

Five years into the recovery of output, unemployment has only marginally declined and remains uncomfortably high, with joblessness at 12½ per cent of the labour force in mid-1996 (labour force survey measure). Even more worryingly, the current pace of net job creations will barely suffice to absorb the foreseeable inflow of youth into the labour force over the next few years. The need for further restructuring and the size of hidden unemployment in rural areas cast doubts on the likelihood of a significant pick-up in employment growth. The *Package 2000* target of bringing registered unemployment down to single digit levels by the end of the decade therefore seems very ambitious. Whether it will be reached partly depends on wage developments and labour market policies: wage moderation in those sectors where productivity is lagging and strict enforcement of eligibility rules for unemployment compensation would help. So would reducing the geographical and skill mismatches between supply and demand of labour,

which continue to be aggravated by the deficiencies of the housing market. Well-designed active labour market policies would also contribute, but in this regard experience in other OECD countries does not offer high hopes. In any event, sound macro-economic policies will be crucial for growth and employment.

Persistently high inflation calls for a tighter fiscal stance

High inflation persists in Poland, 6½ years after the initial stabilisation measures: even though it has remained on a downward trend, it was still running at an annual rate of around 20 per cent (CPI) in the summer of 1996. The near hyperinflation of 1989 drastically reduced zloty money demand, which has only slowly recovered since. The lack of financial depth translates into a smaller tolerance of fiscally induced money creation: a given increase in base money, as a per cent of GDP, will be more inflationary in Poland than in the Czech Republic or in west European countries. Fiscal prudence is all the more needed in Poland as inflation pressures have been building up from the external side, with foreign exchange reserves soaring from 3 to 7½ months of imports between end-1993 and mid-1996 – in part the reflection of a welcome vote of confidence on the part of investors. Tighter fiscal policy over this period would thus have been appropriate to support a more rapid disinflation. This could have been achieved, among other means, by changing the indexation formula for pensions with effect in 1995, as had originally been intended, by moving ahead more swiftly with privatisation sales, and by offering fewer tax exemptions. More aggressive action on the fiscal front would have been justified ex ante by projections of solid growth, and validated ex post by higher-than-projected growth and inflation. This prescription remains largely relevant for 1996-97.

Reserve accumulation has confronted the monetary authorities with a difficult dilemma

On the monetary side, the appreciation of the real exchange rate was appropriate if somewhat belated: if the exchange rate had continued to depreciate at 1.4 per cent per month in the course of 1995, consumer price inflation would have barely declined. The move in May 1995 from a crawling peg to a crawling band, and the recent decision to use the wider margins of the band more actively should help discourage some of the speculative capital inflows that have gathered momentum in 1995 and early 1996. The introduction of administrative controls or a tax on round-tripping operations – advocated by some to ''throw sand in the wheels'' – might serve to reduce inflows. But to limit costly distortions, this type of disincentive would have to be broad-based (non-discriminatory), transparent, and relatively evasion-proof. This last criterion might be impossible to meet in practice for any length of time. Furthermore, this approach would send a paradoxical signal, given Poland's commitment to progressively dismantle its remaining capital account restrictions. On balance, this course of action is therefore not recommended. Further real exchange rate appreciation over and above differential productivity gains was ruled out by the authorities in mid-1996, in light of the turnaround in the trade and current accounts, which were still in surplus in 1995 (taking into account net unrecorded exports) but could end up in the red in 1996. Although the external balances should be viewed in conjunction with the dynamism of investment and output, and the induced imports, the sharp slowdown in export growth and level of dollar wages compared to the other Visegrad countries justify the authorities' circumspection. Admittedly, the monetary authorities have been facing an unpleasant dilemma: lower interest rates to stem capital inflows risk fuelling domestic inflation; higher interest rates attract more capital inflows, making liquidity control more difficult; and sterilisation heavily burdens the budget. The central bank has been pursuing a policy of cautious interest rate cuts, follow-

ing rather than preceding recorded disinflation. Given the current level of real interest rates on zloty assets (based on the market's inflation expectations), erring on the restrictive side seems wise if the ongoing expansion of demand for real money balances is not to be jeopardised.

Further disinflation requires more financial discipline

Thanks in part to the weakening of external monetary pressures, the 17 per cent end-year target for CPI inflation in 1996 is likely to be only marginally exceeded. However, a more restrictive policy stance will be needed to achieve the envisaged end-1997 objective of 13 per cent, on the way to single-digit inflation by end-1998.

Structural policies have not always been clear and consistent

Macroeconomic performance is influenced by financial policies but also by the pace of structural reforms. The *Strategy for Poland* spelled out the need to avoid short-term fine tuning and to make the overall business environment more predictable, stating that ''the government will not surprise anybody with its decisions''. In practice, transparency and stability have not always been the hallmarks of foreign trade, industrial and privatisation policies over the period under consideration. Likewise, the only aspect of pension reform that has become clearer over time is its urgency. The relative lack of stability in public policy parameters was exacerbated in 1994-95 by recourses to the Constitutional Tribunal and other tactical moves which created unnecessary uncertainty and resulted in procrastination.

Many trade barriers are being brought down, but some others have been erected

In the area of foreign trade, several factors have heightened competitive pressures on Polish producers since 1994, both on domestic and export markets: import tariffs are being gradually reduced in the context of the Uruguay, EU and CEFTA agreements; the implementation of Partnership and Co-operation agreements between the EU and some of the Newly Independent States improves the latter's access to

the EU market; and real exchange rate appreciation squeezes exporters' margins (although it reduces importers' costs). In this context, protectionist forces have lobbied for various types of offsetting measures, some of which have been adopted, in particular by invoking the restructuring clause contained in the EU agreement, but also by erecting or reinforcing non-tariff barriers. While these measures have generally not been against international agreements, they do encourage rent-seeking (including by foreign investors), offer scope for discrimination and lessen the restructuring imperative. Some of those measures are also difficult to reverse in practice, as illustrated by the import surcharge, which had been officially introduced as a short-run expedient but will have remained in place for four years. The same holds for tariff quotas involving lower duties on predetermined quantities of imports, which require a system of import permits and therefore create room for rent-seeking. In addition to industrial policy considerations, tariff quotas are motivated as an anti-inflation device, most recently in the case of grain. In that respect, it ought to be recognised that the implied loss of fiscal revenue mitigates the hoped-for disinflation gains.

Required relative price adjustments should not be indefinitely postponed

Another administrative device to contain inflation has been the postponement of administrative price increases, notably for energy. Timing such adjustments so that they do not cause unjustified alarm on the part of casual inflation watchers is appropriate: it is indeed advisable to spread them out somewhat. However, the temptation to indulge in repeated delays of the relative price adjustments that are desirable on structural grounds is self-defeating over the medium run. The same applies to the harmonisation of VAT rates, which should be allowed to proceed at the pace envisaged in *Package 2000*. Misaligned prices or taxes have a fiscal cost in the form of maintained subsidies or

revenue losses, and thus lead to potentially distortionary compensatory taxation or inflation.

Restructuring needs to be furthered; helping out the losers may have some perverse effects

More generally, the aggregate output costs, if any, of prudent monetary policy will be minimised if prices and wages are flexible enough to settle on the right levels. Otherwise, the burden will fall too heavily on the emerging private sector. In this regard, restructuring in many state-owned enterprises is insufficiently advanced. The inclination to identify and help ''losers'' and ''winners'' is still manifest in many government programmes. In some, the preferred solution is the consolidation of weaker and stronger firms, in the name of economies of scale and scope. However, big is not necessarily beautiful, and mergers can result in off-budget cross-subsidisation and delayed restructuring instead of blooming synergies. An alternative approach to help ''losers'' has been to identify distressed regions and grant incumbent enterprises and potential entrants special tax and other advantages. Such ''positive discrimination'' actions may divert rather than foster investment, and tend to spur competition among regions to attract investors, with the attendant losses in tax receipts and politicisation of decisions. Local privileges should therefore be strictly conditional on uniform and transparent criteria, and limited in time.

State divestiture has progressed but still has a long way to go

The large-scale redistribution of property rights over productive assets has been one of the most complex tasks in the transformation, and is far from complete, notwithstanding the multitude of methods tried out. Wholesale ownership transfer is intrinsically difficult because some of the existing stakeholders have strong incentives to oppose it. To explain the relative sluggishness of the process, it has been argued that speed is not what really matters, and should not prevail over equity considerations, not least

because the ultimate aim is not private property as such but enterprise efficiency. It has further been maintained that some sectors are of strategic importance and that the state therefore cannot relinquish control. Insufficient domestic savings has also been put forward as a constraining factor. This line of reasoning is not fully convincing. Privatisation is not sufficient but certainly helpful to improve corporate incentives and governance. Experience in other OECD countries suggests that the notion of strategic sectors or enterprises is often a veil of rhetoric disguising vested interests to retain state-budget protection. Furthermore, the alleged thinness of demand for state-owned assets is not an insurmountable limitation: the potential supply of foreign capital is virtually unbounded, and the long-awaited creation of pension and closed-end funds could help mobilise a larger pool of domestic savings. At the same time, privatisation should not be viewed in isolation but as one element in a broader set of policies, ensuring in particular that competition is allowed to operate, and that even where the state retains a controlling share, business is conducted on a market basis. Privatisation still has testing times ahead with some very large operations envisaged over the next few years. A *Programme of State Assets Privatisation to 2000* that has been under preparation for some time is to spell out which sectors are to remain in the public sphere beyond the end of the century. It would be advisable not to exclude from the scope of privatisation those activities that have been successfully transferred to the private sector in a number of other OECD countries.

Some privatisation routes are more promising than others

Regarding the methods of ownership transfer, the experience built up thus far suggests that selling equity to outsiders, notably to foreign investors, will improve incentives and corporate governance. The pace of privatisation might be increased by the recent delegation of small and medium-

scale divestiture operations to local governments, provided that the latter are given the incentives not to block the process. Commercialisation of state-owned firms should be a step toward privatisation, not an excuse to defer it. One of the still unresolved questions pertains to the compensation of the owners of property confiscated under communism: although the *Strategy for Poland* noted that ''this problem should have been solved already some years ago'', Poland remains one of the very few countries in central Europe where no law on business property restitution has yet been passed, which is a source of uncertainty hampering some privatisation deals.

Banks are now healthier

In contrast with many other transition countries, significant progress has been made with the rehabilitation of the banking sector. An astutely designed, one-time, bank recapitalisation and loan restructuring programme was implemented in 1993-96. Coupled with tightened supervision norms, and helped by the vigour of the general economic recovery, this led to a distinct improvement in banks' profit and prudential ratios. Nevertheless, some banks remain a factor of financial fragility. A priority is now to speed up bank privatisation. In this regard, complex bank merger schemes were put forward by the authorities with a view to build ''national champions'' prior to privatisation. Some of them have sparked vivid controversies without quickening state divestiture.

Little has been done so far to reform the pension system

Perhaps the single most important pending reform is the overhaul of the pension system, a priority noted already in the first two OECD *Surveys*. Despite a broad and long-standing consensus among social partners about the necessity of fundamental changes, little has happened so far. The rise of pension outlays as a share of GDP has been stemmed thanks to buoyant economic growth and, in 1996,

to the change in the indexation rule. However, at about 16 per cent of GDP, and given demographic trends, this share is disquietingly large, far exceeding that in neighbouring countries.

A funded tier should be created alongside the pay-as-you-go one

The move toward a multi-pillar arrangement with a smaller pay-as-you-go component and at least one funded tier is indispensable to safeguard the financial viability of the pension system. It would also have several beneficial side-effects. By making more explicit the link between individual contributions and pensions, it would bolster households' propensity to save, at least if the funded tier is large enough. The creation of pension funds would further contribute to the development of a still very narrow securities market. The transitory financial cost of phasing in a funded tier is large, implying that the reform should be spread out over several years, and hence that it should start early. To ease the burden and to speed up privatisation at the same time, it has been proposed to endow the pension funds with part of the state's remaining holdings of enterprise and bank shares. A challenge would be to ensure that such an unrequited transfer of state assets be carried out equitably. A risk associated with linking pension reform and privatisation is that cross-conditionality may end up delaying both.

The benefits of sustained aggregate growth are spreading

The early 1990s saw a deterioration in many welfare indicators, including a sharp increase in measured poverty, linked with an upsurge in open unemployment. Opinion polls show that, as aggregate output growth resumed, unemployment peaked, and household incomes picked up, the population at large started to acknowledge improvements in their own and in the country's situation. It was only in late 1995, however, that the number of feel-good answers exceeded the number of feel-bad ones, with one

fifth of respondents still in doubt. The benefits of the recovery have thus started to ''trickle down''.

Adjustment should not be postponed

The *Strategy for Poland* stressed the need to ''decrease the social cost of the reforms''. The increased targeting of some social benefits goes in this direction. As noted, a major step still ahead is pension reform, in the absence of which the costs will be unduly shifted across generations. While the necessity to share the burden of adjustment and to nurture a consensus on the merits of reform is clear, there is a risk that in the name of fairness some sectoral interests will impede the needed changes. For example, in the case of hard coal mining, it is being argued that production has to be kept on a ''social'' level. A broader and more forward-looking posture is definitely called for: the social costs of adjustment need to be faced now, when the aggregate recovery is in full swing, rather than postponed and increased by further protection and denial of negative externalities.

Environmental welfare has improved but much remains to be done

An important dimension of welfare is the state of the environment. At the onset of transition, Poland faced one of the worst ecological legacies in the region, not least due to a traditional over-reliance on coal. Acutely aware of the extent of the problem, policy-makers decided to confront the challenge and the actions taken were among the most resolute in central and eastern Europe. A significant role was given to economic incentives to promote clean-up efforts and greener growth, with a fair measure of success. Despite the sharp drop in emissions recorded in the first half of the 1990s and the foreseeable further improvements, convergence to west-European standards can only be envisaged over the long haul, and will require additional efforts.

Sound policies will foster convergence towards average OECD living standards

Per capita income in Poland has been rising rapidly over the past few years and presently stands at close to one third of the OECD average (valued at purchasing power parity exchange rates). The interaction of sound macroeconomic and structural policies as discussed in this *Survey* should ensure that the momentum of the convergence of living standards is sustained.

I. Macroeconomic policies, performance and prospects

Most macroeconomic performance indicators improved markedly in 1994-95, a trend broadly confirmed so far in 1996. This chapter analyses the pick-up in output growth, the turnaround in unemployment, and the progress made with financial stabilisation over this period. It also discusses the broad lines of the outlook through 1997.

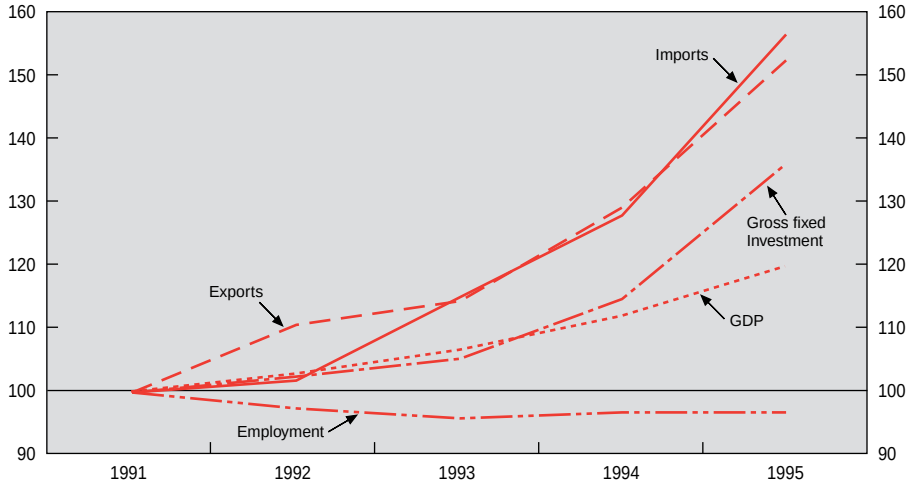
Export and investment-driven growth

The first OECD *Survey* of Poland focused on the transformational depression of 1990-91 and the second one on the subsequent recovery. The emphasis in this *Survey* shifts to the sustainability of vigorous growth. In 1994-95, the Polish economy grew more than twice as fast as the OECD average. Growth became increasingly broad-based, even though sharp sectoral contrasts persisted. To a large extent, the strength of the expansion resulted from rapid integration with western Europe and into the world economy at large, as witnessed by an upsurge in exports and imports (Figure 1). Helped by improving profitability and tax inducements, fixed investment boomed, and in 1995 its contribution to the expansion of GDP stood at par with that of household consumption, boding well for future growth potential.

An impressive growth record

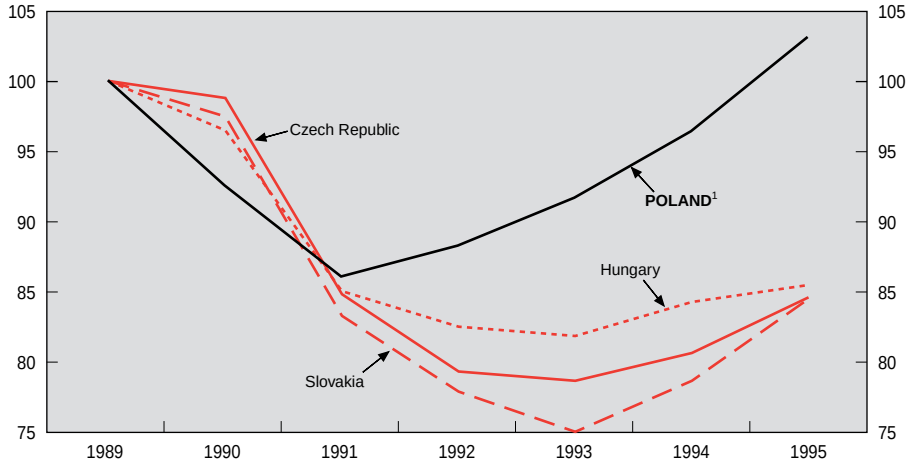
Poland was the first among the countries in central and eastern Europe to recover following the initial output collapse associated with transition (Figure 2). The pace of real GDP growth rose continuously from 1992, reaching 5.2 per cent in 1994 and 7 per cent in 1995. Actual growth thus significantly exceeded the

Figure 1. **THE TAKE-OFF**
Index 1991 = 100



Source : Central Statistical Office.

Figure 2. **OUTPUT: INTERNATIONAL COMPARISON**
Real GDP, 1989 = 100



1. The revised estimate for 1990 is used here (smaller decline).
Source: Central Statistical Office, OECD.

projections for 1994 (4.5 per cent) and 1995 (5.0 per cent) included in the *Strategy for Poland* (Table 1).

Poland has a notoriously vibrant shadow economy, which on some estimates may in recent years have represented almost a fifth of official GDP (Zienkowski, 1996). The above growth estimates largely abstract from economic developments underground, prompting the question of a potential downward bias. In this regard, it ought to be noted that the relative size of the grey economy seems to have declined slightly since 1993, as successful small enterprises find themselves unable to hide any longer, and as efficiency gains in registered enterprises crowd out some of the unrecorded activity (*e.g.*, when supermarkets replace street trading). On that count, the magnitude of the output recovery since 1992 would not seem to be understated by the official statistics.[1]

Growth has become increasingly broad-based as the expansion unfolded. Whereas in aggregate terms growth was initially confined to private firms, output

Table 1. ***Strategy for Poland:*** **Macroeconomic framework**

Year-average real percentage change unless noted

	Targets in *Strategy for Poland*				Outcomes	
	1994	1995	1996	1997	1994	1995
GDP	4.5	5.0	5.2	5.5	5.2	7.0
Consumption	3.1	3.3	3.6	3.6	3.9	4.1
Gross fixed investment	6.0	7.0	8.0	8.0	9.2	18.5
Export volume[1]	6.0	7.0	8.0	9.0	18.3	16.7
Import volume[1]	2.5	4.0	5.2	6.0	13.4	20.5
Foreign trade balance (in per cent of GDP)[1]	–2.1	–1.7	–1.7	–1.5	–4.7	–5.2
CPI (end-year)	23.6	16.1	12.0	8.7	29.5	21.6
Employment	–0.3	0.7	1.3	2.0	1.1	0.3
Unemployment rate (in per cent of labour force, end-year)[2]	17.2	16.7	15.6	14.0	16.0	14.9
Labour productivity	4.9	4.3	3.8	3.5	4.1	6.7
Average wage in the economy (gross)	1.5	2.8	3.0	3.1	1.6	4.6
Average pension (gross)	6.5	1.4	3.1	1.0	4.1	3.2
State budget revenue	5.3	4.3	4.8	5.5	7.1	4.4
State budget expenditure	8.0	8.4	1.8	2.1	6.7	4.2
State budget deficit (in per cent of GDP)	3.7	3.3	2.8	2.5	2.7	2.6
Public debt (in per cent of GDP)	77.7	76.9	74.1	72.4	69.5	56.2

1. Customs-based, excluding unrecorded trade. In 1995, net unrecorded exports may have amounted to close to 4 per cent of GDP.
2. Registered unemployment.

Source: *Strategy for Poland*, June 1994; Ministry of Finance; Central Statistical Office.

in state-owned enterprises (SOEs) also bounced back starting around 1994. In industry, the volume of sales by private entities, which had soared by 34 per cent annually in 1991-93, rose further by 26 per cent annually in 1994-95. Sales of industrial state-owned enterprises (SOEs), which had continued to contract through 1993, picked up in 1994, rising by 4 per cent. In 1995, they shrank by 1 per cent. However, the underlying performance of SOEs is understated by those figures, which do not take into account privatisation, and that of private firms is correspondingly overstated. If changes in title were controlled for, it would probably appear that activity in SOEs continued to expand in 1995, albeit more slowly than in 1994.

Striking contrasts across broad sectors of the economy persisted in 1994, when value-added was rising by 10 per cent in industry, but growth was negative or anaemic in trade, transportation and construction (Table 2). Agricultural value-added collapsed by 15 per cent in 1994, largely because of a severe drought. In 1995, growth rates were somewhat more uniform, with value-added increasing by 4½ per cent in trade, 7½ per cent in construction and 10 per cent in industry. Agricultural output rebounded, with value-added up almost 12 per cent, reflecting a much better harvest.[2]

Table 2. **Growth of value-added by sector**

In per cent

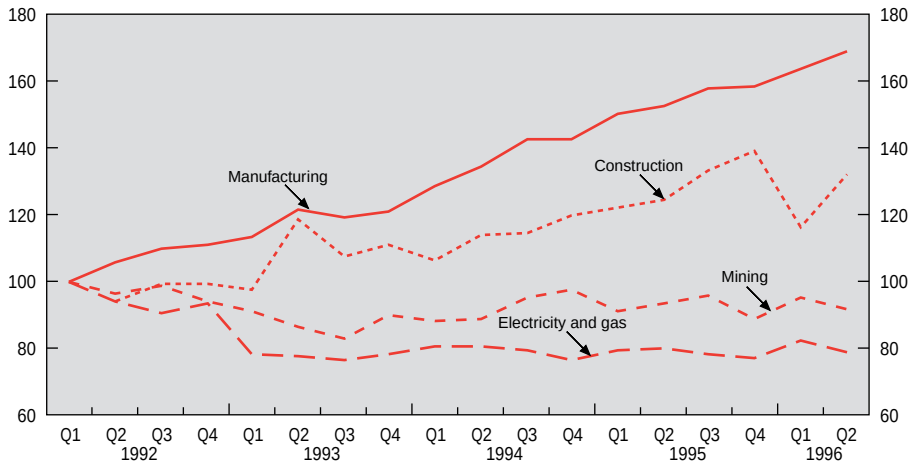
	Share in GDP 1992	1993	1994	1995[1]
Agriculture, forestry, fishing	6.8	5.7	–14.9	11.6
Industry	34.0	8.6	10.3	9.9
Construction	7.8	1.1	2.7	7.3
Trade and repair of consumer goods	13.1	5.8	–1.5	4.4
Hotels and restaurants	0.4	2.3	7.3	5.9
Transport, storage and communication	6.2	–5.3	0.5	3.1
Financial intermediation	0.5	29.1	102.1	19.4
Public administration and defence	6.1	5.2	7.8	4.1
Education	3.8	0.1	10.3	1.4
Health care and social security	4.2	0.5	4.1	2.9
Other	13.0	–8.4	5.2	3.9

1. Preliminary.
Source: Central Statistical Office.

Within industry, more and more branches participated in the overall expansion: the number of major products for which output was still declining dropped from 36 out of 62 in 1992 to 16 in 1994-95 (Annex VI, Table A4). The fastest growth in gross output was recorded in manufacturing, up 13 per cent in 1994 and 12 per cent in 1995 (Figure 3). The more dynamic industries included some technology-intensive ones, such as electronics, telecommunications equipment, automotive, precision instruments and machinery.[3]

At the regional level as well, an increasing number of voivodships experienced growth, with gross industrial output rising in less than two thirds of the 49 voivodships in 1992, and in all but one voivodship by 1994. Concomitantly, the dispersion of regional growth rates declined. At the same time, the proportion of voivodships recording double digit growth rates surged from one quarter to two thirds. In 1995, however, as the pace of industrial growth nation-wide abated from 13 to 9 per cent, the dispersion of regional growth rates rose anew. In cumulative terms, the dispersion has been considerable, implying that disparities at the yearly frequency did not mainly reflect a lack of short-run synchronisation

Figure 3. **PRODUCTION IN THE MAIN INDUSTRIAL SECTORS**
1992 Q1 = 100, seasonally adjusted



Source: Central Statistical Office, OECD.

across voivodships, but that significant and lasting differences in dynamism emerged. Indeed, industrial output declined by 10 per cent between 1991 and 1995 in the most depressed area (Legnickie voivodship) and surged by 140 per cent in the most dynamic one (Nowosadeckie voivodship).

The contribution of foreign trade

As in other central European countries, a key driving force underlying rapid growth has been the even faster expansion of foreign trade. Whereas real GDP increased by some 12½ per cent between 1993 and 1995, the volume of exports and imports of goods and non-factor services rose by 34 and 37 per cent respectively (including the estimated unrecorded cross-border trade flows described in Annex II).

In an accounting sense, the contribution to growth of net exports has been negative, or modest at best (Table 3). However, the surge in exports has underpinned the double digit growth rates recorded in a number of industrial sectors. At the same time, intermediates and investment goods constituted the bulk of imports, with the share of the former around 65-70 per cent, and the share of the latter around 13-15 per cent. Outward processing – *i.e.*, the importation of inputs

Table 3. **Contributions to growth**[1]

In per cent

	Share in GDP 1992	1992	1993	1994	1995
Consumption	78.4	2.7	4.0	3.3	3.5
Personal consumption	54.7	1.3	3.2	2.7	2.9
Public consumption	23.7	1.4	0.8	0.6	0.6
Gross capital formation	18.6	–2.8	1.9	1.4	4.4
Gross fixed investment	21.5	0.5	0.5	1.5	3.0
Stockbuilding	–2.9	–3.3	1.4	–0.1	1.4
Domestic demand	97.0	–0.1	5.9	4.7	7.9
Exports of goods and non-factor services	32.7	3.2	0.8	3.0	4.3
Imports of goods and non-factor services	–29.7	–0.5	–2.9	–2.5	–5.2
Gross domestic product	100.0	2.6	3.8	5.2	7.0

1. Calculated based on constant prices of previous year, except for 1992 (based on constant prices of 1990).
Source: Central Statistical Office.

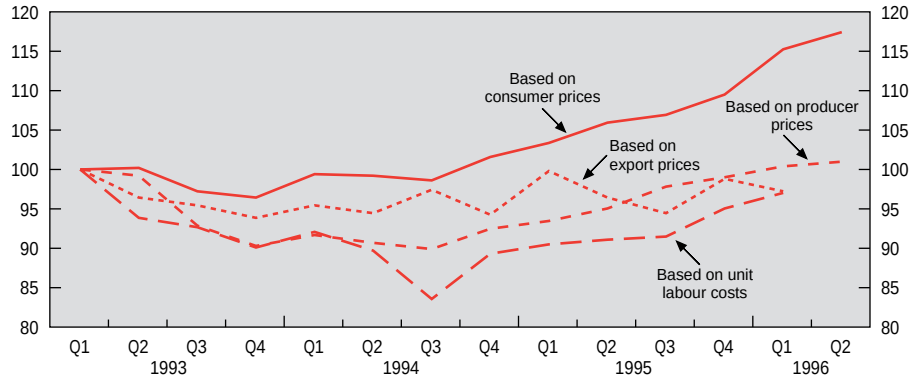
that are processed in Poland and then re-exported – accounted for an increasing share of foreign trade. In 1995, this share reached 24 per cent for exports and 12 per cent for imports (in light industry, 82 and 62 per cent respectively).[4] Thus, far from being a symptom of excess demand, import growth was largely associated with the development of the supply side of the Polish economy.

By 1995, trade with countries of the European Union (EU) represented some 70 per cent of exports and 65 per cent of imports (customs basis, excluding unrecorded cross-border trade). Germany remained by far the largest trading partner, absorbing some 38 per cent of exports and accounting for 27 per cent of imports. After several years of pronounced declines, trade with other countries in transition started to pick up in 1994, but their share remained small, at 17 per cent of exports and 15 per cent of imports in 1995. With such a large portion of sales abroad destined for the EU area, the resumption of growth in western Europe in 1994 contributed significantly to the rise in Polish exports. The revival of trade with countries of the former Soviet Union, notwithstanding a continuing overall contraction in that region, reflected the development of new, private-based trade links. Among the most spectacular increases were those of Polish exports of food and machinery to Ukraine and Russia. The associated market share gains may be reversed in the future, however, once structural reforms in those countries are advanced enough to generate a big, positive supply response.

Another important factor underlying the expansion of trade with EU countries in 1994-95 has been the ongoing liberalisation in both directions, in line with the provisions of the EU Association Agreement and with GATT and WTO commitments (Chapter IV). Nevertheless, the impact of the lowering of trade barriers should not be exaggerated. In a number of sectors where exports and imports boomed, tariffs and other restrictions were already not that high in 1993. In others, Polish exporters did not take full advantage of the preferences (duty-free quotas and the like) provided by the EU Agreement, partly due to the cumbersome associated administrative requirements.[5] Moreover, some anti-dumping actions and other restrictive measures were taken by EU countries that inhibited Polish exports.[6] More generally, the ongoing trend towards increased contingent protection that seems to accompany the lowering of tariffs and the phasing out of quotas may discourage some potential exporters and restrain the expansion of trade.

The price competitiveness of Polish producers constitutes another factor underlying the export boom. Nominal exchange rate, price, wage and productivity developments led to a large drop in relative unit labour costs in 1994 (Figure 4). However, this decline was reversed in 1995, mostly in the last quarter. Dollar wages in industry (including bonuses) rose by 44 per cent, to about $400 per month, in the two years to December 1995 (in deutschemarks, they increased by 20 per cent over the period). In late 1993, wages expressed in foreign currency were in the same broad range as in the Czech Republic and Slovakia, but distinctly lower than in Hungary and Slovenia. By the end of 1995, even if it remained considerably below that in Slovenia, the wage level in Poland had soared well above that in Hungary and Slovakia, standing on par with the (also much increased) level in the Czech Republic.[7] Nevertheless, Polish wages were still only a fraction of German wages at the end of 1995. Profitability continued to be higher in the export sector than in the rest of Polish industry in 1995, consistent with the fact that wage gaps *vis-à-vis* EU countries remained larger than productivity differentials. Nevertheless, relative unit labour costs have

Figure 4. **REAL EXCHANGE RATES**[1]
Q1 1993 = 100



1. Effective real exchange rate *vis-à-vis* US dollar, German mark, British pound, French franc, Austrian schilling, Swiss franc, Dutch guilder, Italian lira, Swedish crown, Danish crown, and Belgian franc; weighted by shares in foreign trade.

Source: National Bank of Poland.

become high enough in some Polish firms to induce them to employ cheaper Russian or Ukrainian labour in Poland and to consider outsourcing some production in CIS countries.

The investment boom

In 1992, growth had been mainly pulled, on the demand side, by domestic consumption and exports, and in 1993, by domestic consumption (Table 3). In 1994-95, the contribution of exports and investment increased markedly. For the first time since the turnaround in output, fixed investment volumes rose faster than GDP, by 9 per cent in 1994 and 18½ per cent in 1995. The rebound of investment starting in 1994 was helped by the tax concessions introduced at the beginning of the year. It was also spurred by strengthening corporate earnings. In 1995, the sharp pick-up in foreign direct investment and the revival of bank credit also played an important role, even though the bulk of investment continued to be financed from retained earnings.

The revival of investment in 1992-93 was principally attributable to small and medium-sized enterprises, as large ones were still cutting investment expenditures further. In 1994-95, fixed capital formation increased in both groups but private sector investment continued to significantly outpace investment in the public sector (SOEs and administrations). Over time, the sectoral composition of investment outlays has shifted away from trade and towards manufacturing. At the same time, the structure of investment has seen an increase in the share of purchases of machinery and equipment. Reflecting those trends, investment in 1994-95 turned out to be most buoyant in private manufacturing companies, particularly in those with foreign capital participation.

Housing investment trends did not change much in 1994-95, with a continuation of the decline in the number of completed flats and of the increase in the number of private houses built. Infrastructure investment *lato sensu* has been remarkably dynamic over the past few years. Existing trading facilities have been revamped and new trade centres established. Existing telephone exchanges have been automated and new ones built, the number of subscribers has increased significantly, and cellular phones are spreading. Investment in power and water supply and sewage systems has also risen rapidly.

In the enterprise sector, investment continued to be mainly self-financed, even in 1995. The provisions broadening the deductibility of investment outlays

introduced in January 1994 (for an open-ended period), the relatively subdued evolution of wages, and the sharp increase in profits enabled enterprises to increase capital expenditures considerably. Specifically, investment expenses could be deducted from income up to 25 per cent of the latter, provided that profits exceeded a minimum threshold and in the absence of arrears on taxes and social security contributions. Firms exporting more than half of their production or more than Ecu 10 million benefited from a higher ceiling of 50 per cent of income and were not subject to the profitability criterion. These new tax regulations may have encouraged some firms to cease reporting part of their investment expenditures as current consumption, thus exaggerating the extent of the rebound in investment somewhat. Gross real product wages in industry grew somewhat more than labour productivity in 1994 and somewhat less in 1995, so that year-average real unit labour costs did not change much between 1993 and 1995.[8] These factors, combined with booming sales, contributed to the distinct improvement in the financial results of enterprises: the ratio of gross profits to sales increased from 2.8 per cent in 1993 to 4.1 per cent in 1994 and 4.2 per cent in 1995; the net profit margin from –0.5 per cent in 1993 to 1.7 per cent in 1994 and 2.0 per cent in 1995; and the share in the number of firms of those showing positive net profits from 54 per cent in 1993 to 60 per cent in 1994 and 64 per cent in 1995.[9]

Persistence of high unemployment

Whereas employment continued to decline in the early stages of the recovery, it started to grow anew in 1994, albeit slowly. At the same time, registered vacancies began to rise, and unemployment to fall. Nevertheless, even taking into account hidden employment, joblessness remains very high, including long term and very long term unemployment.[10]

Employment is slowly recovering

Following the 1990-91 contraction, total employment continued to shrink and aggregate investment remained fairly anaemic even as output growth was picking up. At the same time, the apparent productivity of labour rose rapidly, suggesting that there was considerable scope for an increase in production stemming from the reallocation of existing human and physical resources.[11] During

this phase, the new-found freedom to set prices and quantities enabled enterprises to move closer to their production possibility frontier by cutting on inefficient input use. By 1995, and as growth had become broader-based across sectors and regions, investment was booming and the expansion was taking on a more extensive character, with productivity growth slowing down from the double digit rates recorded in 1993-94.

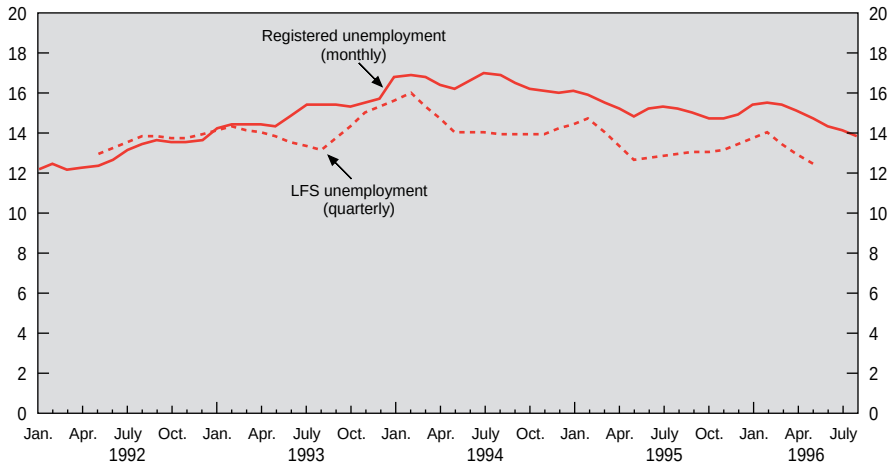
Employment accordingly rose much less than output, increasing by 1 per cent in 1994 and barely at all in 1995. It remains unclear whether this would still be true taking into account hidden employment and output (see Annex III). At a more disaggregated level, employment rose slightly in agriculture and industry in 1994. In 1995, net job creation was positive in industry but negative in agriculture. Employment in services stagnated in 1994 but expanded slightly in 1995.

Accompanying the increase in employment, the number of vacancies notified to labour offices started to rise sharply in 1994, although from a low base, to a flow of 801 000 in 1994 and 914 000 in 1995.[12] Most of the job offers emanated from private enterprises.

Unemployment is shrinking

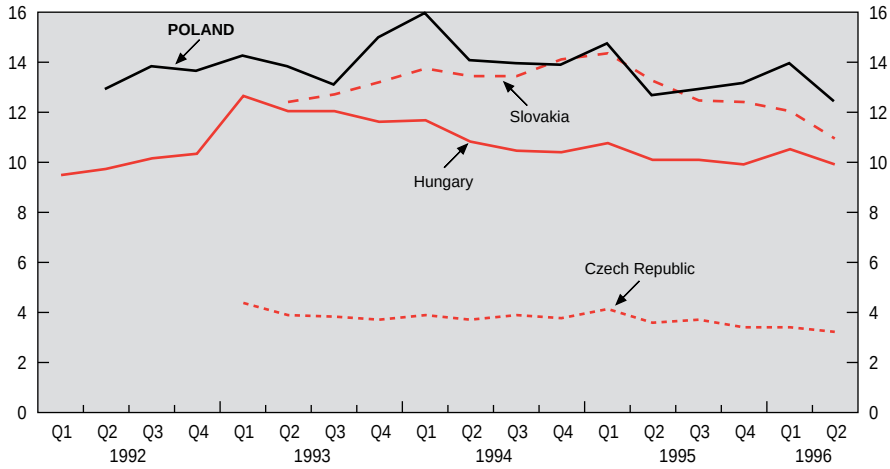
Unemployment as registered by labour offices has been on a downward trend since mid-1994, but remains high, still affecting 2 628 800 persons, or 14.9 per cent of the labour force at the end of 1995 (Figure 5). In the course of 1995, registered unemployment declined in 45 of the 49 voivodships, albeit relatively less in the areas suffering from the highest unemployment rates. Labour force survey (LFS) data point in the same direction,[13] and indicate that the unemployment rate by late 1995 was still as high as 13.1 per cent. Despite Poland's more buoyant output performance, unemployment thus remained distinctly higher than in the Czech Republic and Hungary, and slightly higher than in Slovakia (Figure 6). While a third of those registered as unemployed may actually be employed in the shadow economy or are not really eager to find a job, a large number of people may be searching or wishing for a job but without being registered as such, namely the discouraged unemployed and redundant farm workers (see Annex III).

Figure 5. **UNEMPLOYMENT RATES**
In per cent of the labour force, non-seasonally adjusted



Source: Central Statistical Office.

Figure 6. **UNEMPLOYMENT: INTERNATIONAL COMPARISON**
LFS unemployment in per cent of the labour force



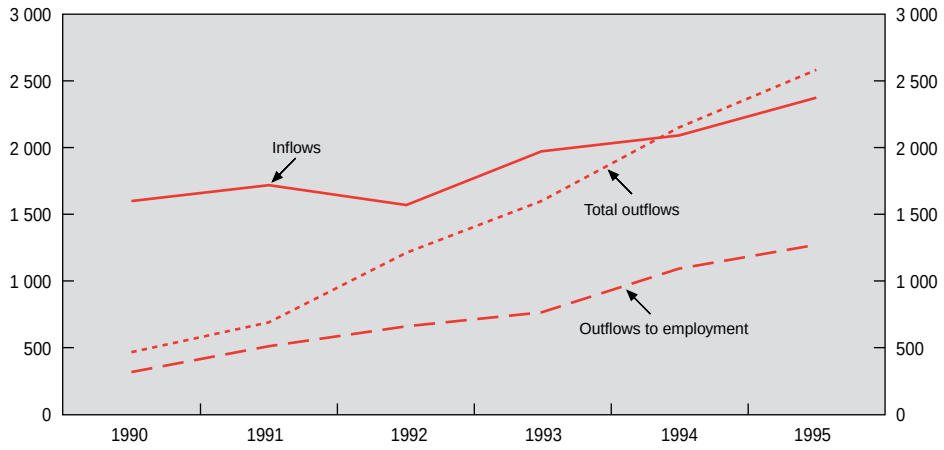
Source: OECD.

As outflows caught up with and surpassed inflows, unemployment began to shrink in 1994 (Figure 7). However, only about half of total outflows were to employment, or at least were so identified by labour offices, and only about 70 per cent of those who thus acceded to a job started permanent employment. A third of the unemployed left the count because they did not confirm their ability to work or renounced their unemployment status. Inflows continued to mount in 1994-95, including for re-registrations. The turnover rate of the pool of unemployed has thus been rising, a sign of increasing labour market fluidity. Meanwhile, based on LFS data, the average duration of unemployment, which peaked at 14.8 months in 1994, edged down by one month in 1995.

In addition, on-the-job search is widespread. Labour force surveys suggest that no less than 6 per cent of the employed are seeking new jobs, compared with 2 to 5 per cent in most EU countries. Over half of the employed jobseekers are searching for alternative employment because they consider that their current position is temporary or at risk of being suppressed.

Figure 7. **REGISTERED UNEMPLOYMENT: INFLOWS AND OUTFLOWS**

Thousands



Source: Central Statistical Office.

Long-term unemployment remains high

The number of long-term registered unemployed (over one year) started to decline at about the same time as total unemployment, in the summer of 1994, but more rapidly. Correlatively, the share of the long-term unemployed dropped from a peak of 45 per cent of total unemployment around mid-1994 to 37 per cent in late 1995, possibly reflecting a more rigorous implementation of registration rules. LFS data show a slightly different picture, indicating that the share of long term unemployed continued to rise during 1994 and most of 1995, from 36 to 42 per cent, but declined in late 1995 to 40 per cent. The share of very long-term registered unemployed – defined as exceeding two years – was stable around 20 per cent during 1994 and declined to 18 per cent in the course of 1995. LFS data show the share of very long-term unemployed rising sharply in 1994, from 13 to 19 per cent, and increasing marginally further in 1995.

As time elapses, the frequency of re-registrations rises. In 1994, 686 000 persons were recorded as unemployed for the second time (counting since 1990) and 217 000 persons for at least the third time; total re-registrations accounted for 43 per cent of all registrations. In 1995, this proportion rose further, to 57 per cent, as 882 000 persons registered for the second time and 458 000 for at least the third time. The number of the recurrently unemployed is thus growing.

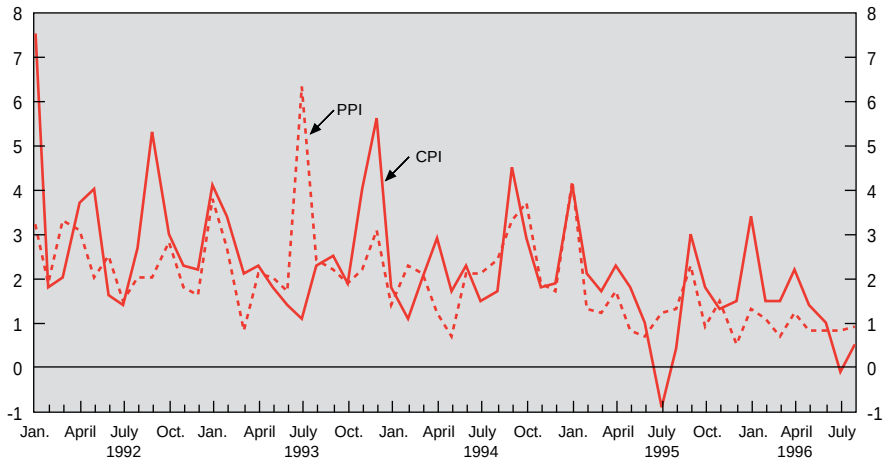
Inflation, indexation and capital inflows

Disinflation continued in 1994-95, albeit even more gradually than targeted by the authorities. It was made more difficult by the sharp rise in monetary aggregates associated with incompletely sterilised reserve accumulation, in a context of fairly widespread indexation behaviour.

Gradual disinflation continued

Since the liberalisation of most prices in 1989-90, inflation has been steadily declining, and by the end of 1995, the 12-month CPI inflation rate was down to its lowest point since 1987. Sporadic short-run deviations from trend have been observed, linked to seasonal factors, supply-side shocks, or tax measures, but, on the whole, disinflation has been sustained, if extremely gradual (Figure 8). Disin-

Figure 8. **INFLATION**
Percentage change month on month

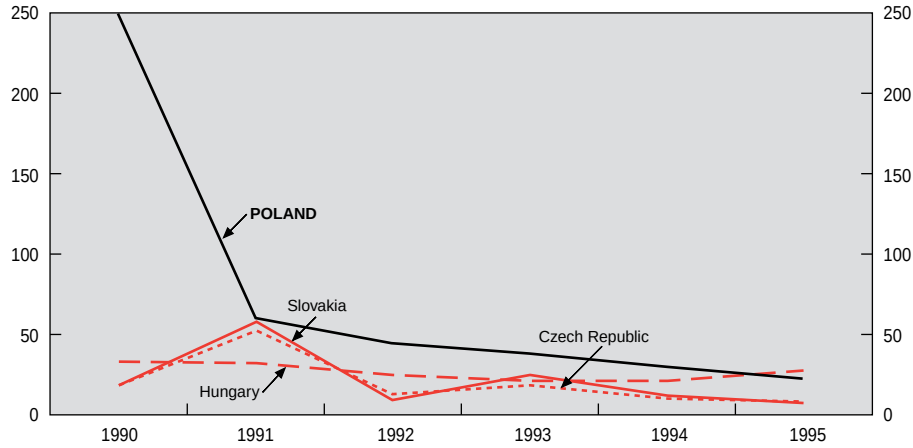


Source: Central Statistical Office.

flation has, however, been slower than targeted by the government in its budgets: the end-year CPI inflation objectives for 1994-95 were exceeded by large margins, with outcomes of 29.5 per cent in 1994 (against a target of 23 per cent) and 21.6 per cent in 1995 (against a target of 17 per cent). Overall, inflation remained much higher than in the Czech Republic and Slovakia, but came down below the level recorded in Hungary (Figure 9).

Relatively tight financial policies, including effective hard budget constraints, have contributed to maintain the disinflation trend in 1994-95. However, a series of adverse climatic developments, including a severe summer drought, pushed agricultural prices up in 1994, all the more as variable import levies on 50 and later 74 agricultural products were introduced in June, probably adding one percentage point to CPI inflation in 1994. Acting in the opposite direction in 1995 were the cuts in import tariffs and/or surcharge implemented in January and July, a good harvest, but also the sale of agricultural products from state stocks and the postponement or limitation of selected administrative price adjustments (in particular for medicines and energy). To that extent, the underlying

Figure 9. **INFLATION: INTERNATIONAL COMPARISON**
CPI, end-year percentage change



Source: Central Statistical Office, OECD.

inflation rate may have declined less markedly in 1994-95 than observed inflation might suggest.

Producer prices in industry rose less rapidly than consumer prices, by 27.9 per cent in 1994 and 18.9 per cent in 1995, due in part to a stronger impact of real exchange rate appreciation on the basket of items covered by the industrial producer price index than on the CPI (as noted, intermediates dominate imports).

Indexation

The hyperinflation of 1989 and the subsequent difficulty to bring inflation down rapidly to single digit annual rates gave rise to fairly widespread indexation, manifested in particular by the short horizons and variable interest rates of financial contracts and the frequent adjustments in wages and pensions. The question arises in this context of the existence of a wage-price spiral. Econometric estimates suggest that during the period 1991-95, nominal wage adjustments to price increases took place with an average lag of about two months (Griffiths and Pujol, 1996), pointing to consistent *de facto* wage indexa-

tion. Prices in turn can be shown to adjust to wage increases, albeit with a longer lag.

The wage policies followed in 1994-95 aimed, to various degrees, to contain wage adjustments. Four different regimes were in effect during that period, which all allowed for some link between enterprise performance and wage awards in order not to discourage efforts at productivity improvements. During the first quarter of 1994, a modified form of ''excess'' wage tax (*popiwek*) remained in place, with a maximum marginal rate of 300 per cent, but with some latitude for enterprises to opt for one of three different types of rules. A new law regulating wages that Parliament passed in March 1994 was vetoed by the President. During the ensuing legal vacuum, which lasted through July, wages in SOEs rose rapidly. From August to December 1994, a new set of income policy rules was in place, involving four distinct options, of which two represented amended versions of the *popiwek* (for details, see the previous *Survey*). During this period, nominal wage growth in most enterprises did not exceed the normative ceiling, as attested by modest excess wage tax intakes.

In January 1995, a new system of collective bargaining came into force, applying to enterprises employing at least 50 people. A consensual approach based on social partnership thereby replaced tax-based income policies. Each year, the national Tripartite Commission for Socio-Economic Affairs (including government, union and enterprise management representatives) is to set quarterly target maxima for wage increases chargeable to costs, based on projections for GDP, inflation and maximum wage increases provided by the government. For SOEs, the sanction for exceeding the targeted maximum, when performance has deteriorated, is a cut in the profit-related bonus of the managing director or even his dismissal; a small number of directors were removed on those grounds in 1995. The wage norm included almost all benefits, in an attempt to prevent the pervasive circumvention that characterised the earlier experience with the *popiwek* (see Estrin *et al.*, 1995). Benefits not covered by this norm were subjected to other restrictions and thus in principle also under control.

For 1995, the ceiling was set at 23.5 per cent for the yearly average, *i.e.*, slightly above the 22.7 per cent CPI inflation objective. It soon appeared that inflation was running faster than programmed, and the ceiling was adjusted in July to 27 per cent. In the fall, trade unions pushed for a second revision of the

norm but the government refused, arguing that a significant increase in the real wage would be achieved in 1995 without a new relaxation of the income policy.

In practice therefore, the new wage policy can be described as one of *de facto* indexation.[14] Ceilings tend to serve as a co-ordination mechanism in the wage bargaining process, facilitating the lobbying for maximum wage awards on the part of workers in weaker firms. The accommodation of higher than projected inflation by an adjustment of the norms acts in the same direction. However, the system preserves room for discretion, allowing the authorities to resist full and automatic indexation. Besides the issue of the effectiveness of the incomes policy as a nominal anchor for disinflation, such a corset has been criticised on efficiency grounds, as contributing to rigidify wage differentials across companies (albeit less than the earlier, tax-based formulas).

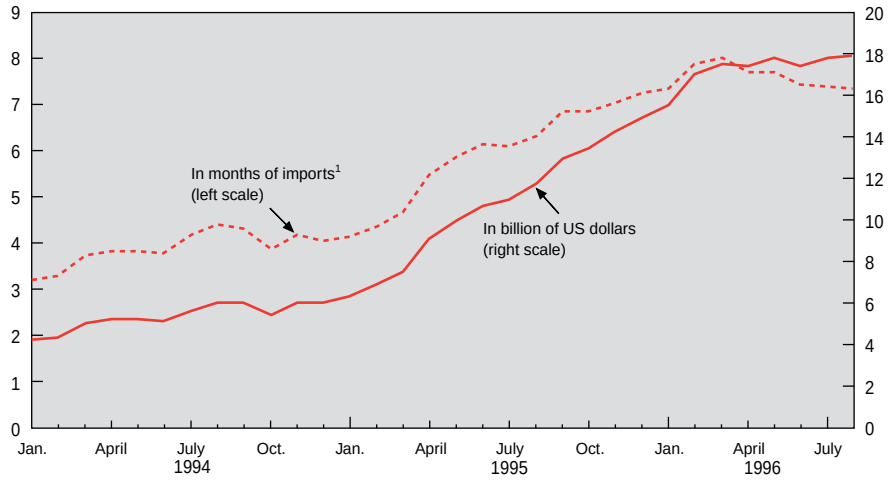
From 1991 to 1995, pensions were indexed to wages. Adjustment was automatically triggered by a 10 per cent rise of the quarterly average wage since the last adjustment.[15] The pension increase, however, would be implemented with a lag, on the third month of the following quarter. In view of the growing burden of pensions, the link between pensions and wages was severed from 1996. After some legal wrangling, the government replaced automatic indexation by a single 15.2 per cent adjustment in September, to be followed by an additional adjustment in March 1997 in case inflation were to run faster than projected in the budget, in order to ensure a 2.5 per cent annual increase in real terms.[16] Agreement still needs to be reached on the increase to be granted for 1997 (Chapter III).

Monetary policy

On the monetary side, an increasingly important inflationary factor in 1994-95 was the rapid accumulation of foreign exchange reserves (Figure 10), which caused money supply to grow much faster than projected. The reserve build-up resulted from a large trade surplus (taking into account unrecorded trade) and, increasingly, from capital inflows *stricto sensu.* Over the same period, money demand strengthened significantly.

The total money supply (including foreign exchange deposits) rose by 38.2 per cent in 1994 (against a projected 27.9 per cent) and by 34.9 per cent in 1995 (against a projected 22.8 per cent). In both years, the expansion of net foreign assets far exceeded projections, contributing to 40 per cent of the expansion in the money stock in 1994 and 85 per cent in 1995 (Annex VI, Table A5).

Figure 10. **GROSS OFFICIAL FOREIGN EXCHANGE RESERVES**



1. Moving average of monthly imports over the last 12 months.
Source: National Bank of Poland.

Financing of the fiscal deficit accounted for half of money creation in 1994 but only for 5 per cent in 1995. The growth in credits to enterprises and households contributed about as much as net foreign assets to the increase in money supply in 1994, but only two thirds as much in 1995.[17] Whereas credit to the economy was still declining in real terms in 1994, it picked up in 1995, both for enterprises and for households. The share of the latter in the stock of credits to the non-financial sector expanded from 7 per cent at end-1993 to 10 per cent at end-1995, in part reflecting the superior payment record – so far – associated with consumer credits.

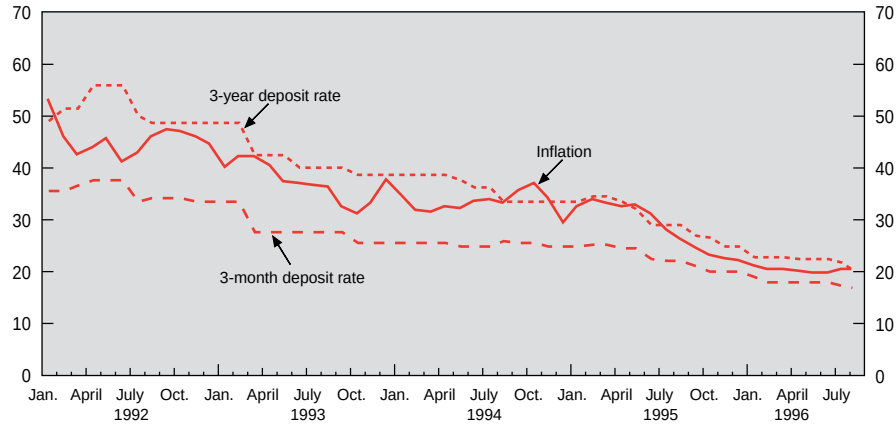
Whereas the bulk of the spectacular build-up of foreign exchange reserves in 1994-95 resulted from a large, albeit poorly measured, trade surplus, capital inflows have clearly gained importance over the period, not least in the wake of the finalisation of debt forgiveness negotiations with commercial bank creditors in 1994 (described in the previous *Survey*). The inflow of foreign direct investment, as recorded on a cash basis in the balance of payments, more than doubled in 1995, to $1.1 billion. Portfolio investment, particularly in government securi-

ties, also picked up, spurred at times by widespread expectations of nominal exchange rate appreciation.

In 1994, the authorities' policy reaction to the expansion of reserves mainly involved attempts at sterilisation, complemented – progressively – by a firming of exchange rate policy coupled with a series of interest rate cuts. Notwithstanding arguments and pressures on the part of the Ministry of Finance for bolder interest rate cuts, the National Bank of Poland (NBP) proceeded cautiously. In 1994, headline interest rates were cut once, in May, by 1-2 percentage points (Annex VI, Table A6). Open market operations – including reverse repos, sales of T-bills, and auctions of NBP bills (starting in 1994) –were used extensively in order to mop up excess liquidity, but the accumulation of reserves was not fully sterilised. In this context, market interest rates on zloty assets declined (Figure 11). Modest reductions in the pre-announced monthly rate of crawl of the zloty were implemented, from 1.6 to 1.5 per cent in September 1994, and to 1.4 per cent in November (Figure 12).

Figure 11. **INFLATION AND INTEREST RATES**[1]

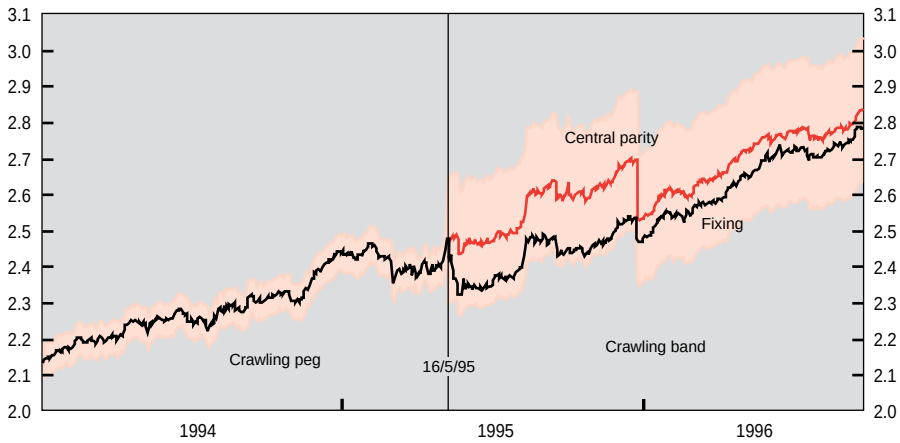
Per cent per annum



1. Inflation is measured by the 12-month rate of increase in the CPI. Interest rates are the mid-points of the range of rates offered by the main commercial banks on 3-month and 3-year zloty deposits.

Source: Central Statistical Office, National Bank of Poland.

Figure 12. **NOMINAL EXCHANGE RATE DEVELOPMENTS**
Zloty/USD, January 1994-September 1996
Daily observations



Source: National Bank of Poland.

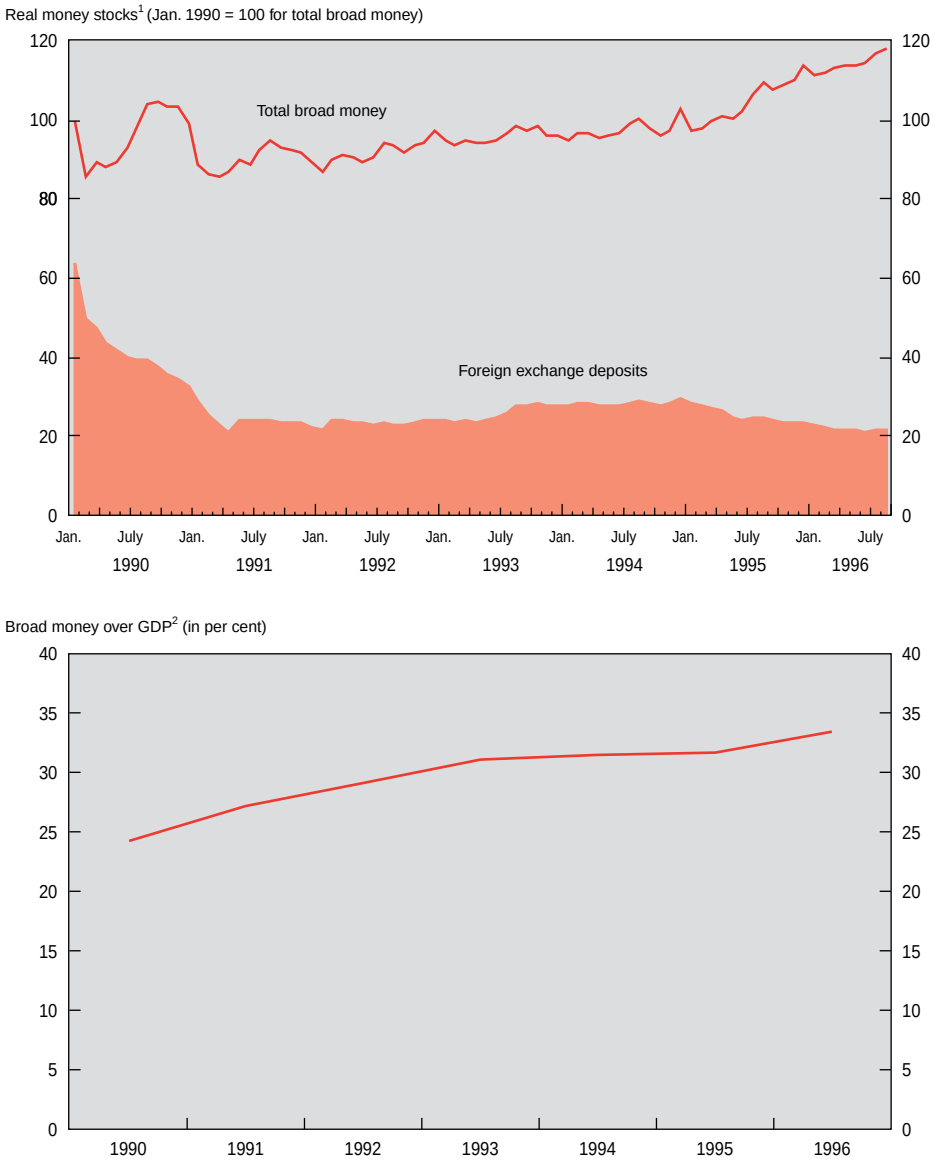
Somewhat bolder exchange rate policy action was taken in the first half of 1995, with a further cut in the rate of crawl to 1.2 per cent in February, a widening of the NBP exchange rate spread in March to ±2 per cent, and the introduction, in mid May, of a ±7 per cent band around the central parity, which within weeks was followed by a 5 per cent nominal appreciation of the market rate. Headline interest rates, which had been raised by 2-3 percentage points in February in the wake of a high January inflation outcome, were lowered by 4 percentage points in May, and by a further 2 percentage points in September. The scale of NBP drainage operations on the money market continued to rise in 1995, reaching Zl 12.7 billion by December 1995 (compared to Zl 0.7 billion in December 1993 and Zl 4.8 billion in December 1994).[18] In late December, the central parity of the zloty was revalued in a 6 per cent step-appreciation, which was followed by a 2.5 per cent appreciation of the market rate. In January 1996, the pre-announced monthly rate of crawl was reduced to 1.0 per cent, and headline interest rates were cut by 2 percentage points, to 26 per cent for the Lombard rate and 23 per cent for the rediscount rate.

In sum, between the summer of 1994 and early 1996, the annualised rate of crawl of the nominal exchange rate was cut from 21 to 12½ per cent, headline interest rates were reduced by between 5 and 7 percentage points, and the producer price based real effective exchange rate appreciated by 12 per cent. With the benefit of hindsight, it might have been preferable to appreciate the zloty earlier, in the second half of 1994, at the time when the summer drought was adding to inflationary pressures. Once the decision to allow the zloty to appreciate had been taken, in the early months of 1995, it took a fairly long time to be implemented (partly due to a simultaneous change in the exchange rate system), thus fuelling one-way speculative bets.

In addition to these exchange and interest rate policy actions, regulatory measures were taken or considered to counteract the forces underlying reserve accumulation. Import tariffs and the import surcharge were cut several times (Chapter IV). In December 1995, the surrender requirement for export proceeds was abolished, which should also reduce conversion costs borne by enterprises. The NBP reportedly pushed for restricting purchases of Treasury bills by non-residents, but no such limitation was introduced.

Significant de-dollarisation and re-monetisation took place in 1994-95 (Figure 13). Whereas the share of foreign currency deposits in total money increased in 1993,[19] this trend was arrested in 1994, when this share marginally declined, to 28.5 per cent. In 1995, reverse currency substitution, understood as a shift back into zlotys, occurred on a much more pronounced scale, and the share of foreign currency deposits shrank to 20.4 per cent. Owing to memories of spoliation associated with earlier monetary reform episodes, the redenomination of the zloty in January 1995 prompted households to convert the zloty equivalent of an estimated $700-800 million into foreign exchange in late 1994, and caused a switch in the opposite direction in early 1995, which exaggerates the contrast between 1994 and 1995.[20] The move into zlotys was largely driven by the sharp improvement in the return on zloty assets compared to dollar ones. *Ex post* dollar returns on 12-month zloty deposits surged from 7 per cent in 1993 to 18 per cent in 1994 and 29½ per cent in 1995, even as the returns on 12-month dollar deposits declined from 6½ to 4½ per cent.[21] At the same time, households' propensity to save started to increase across all income groups, and deposits of households rose in real terms by 4.7 per cent in 1994 and 13.6 per cent in 1995. Concomitantly, the share of cash zloty in total zloty money declined, from

Figure 13. **REMONETISATION AND FINANCIAL DEEPENING**



1. The CPI is used as a deflator.
2. Average of end-year and end-of-previous year money stock over nominal GDP. For 1996, the projection shown reflects the budget law and the associated *Monetary Guidelines.*

Source: Central Statistical Office, National Bank of Poland.

25.1 per cent at end-1993 to 23.5 per cent at end-1995, reflecting a greater attractiveness of deposits (including as a result of the introduction of a formal deposit guarantee scheme), and possibly the apparent decline in the share of the shadow economy. Among zloty deposits, the share of time deposits increased from 63.8 per cent at end-1993 to 68.7 per cent at end-1995.

As mentioned earlier, a notable dimension of financial deepening was the revival of credits to enterprises and households. In 1992-94, banks were generally reluctant to extend new credits, preferring to buy risk-free Treasury bills. However, as the clean-up of balance sheets undertaken under the 1993 Act for the Financial Restructuring of Enterprises and Banks proceeded (Chapter II), banks started to show a greater inclination to grant new credits, and to lengthen their maturity. In 1995, the nominal stock of corporate loans rose by 32 per cent and that of consumer credits by 68 per cent, implying large increases in real terms.

Fiscal management

In 1994-95, revenues and expenditures grew broadly in line with GDP. Thus, the deficit to GDP ratio did not undergo major changes, and stayed below the 3 per cent mark. At the same time, the public debt ratio declined sharply, mainly as the result of large-scale relief granted by foreign creditors and real exchange rate appreciation. The burden of debt service payments, however, rose significantly, despite the lengthening of the average maturity of the domestic debt.

Fiscal trends

Since 1993, the cash deficits of the state budget and of the general government (*i.e.*, including local budgets, social security and other extra-budgetary funds) have remained below 3 per cent of GDP, even excluding privatisation receipts other than leasing revenue (amounting to 0.8 per cent of GDP in 1995) (Table 4, Figure 14).

Both in 1994 and 1995, higher-than-projected growth and inflation helped contain the deficit of the state budget below target. The growth bonus broadened the real tax base. The net impact of extra inflation was also positive as in the

Table 4. **General government revenues, expenditures and balance**

In per cent of GDP

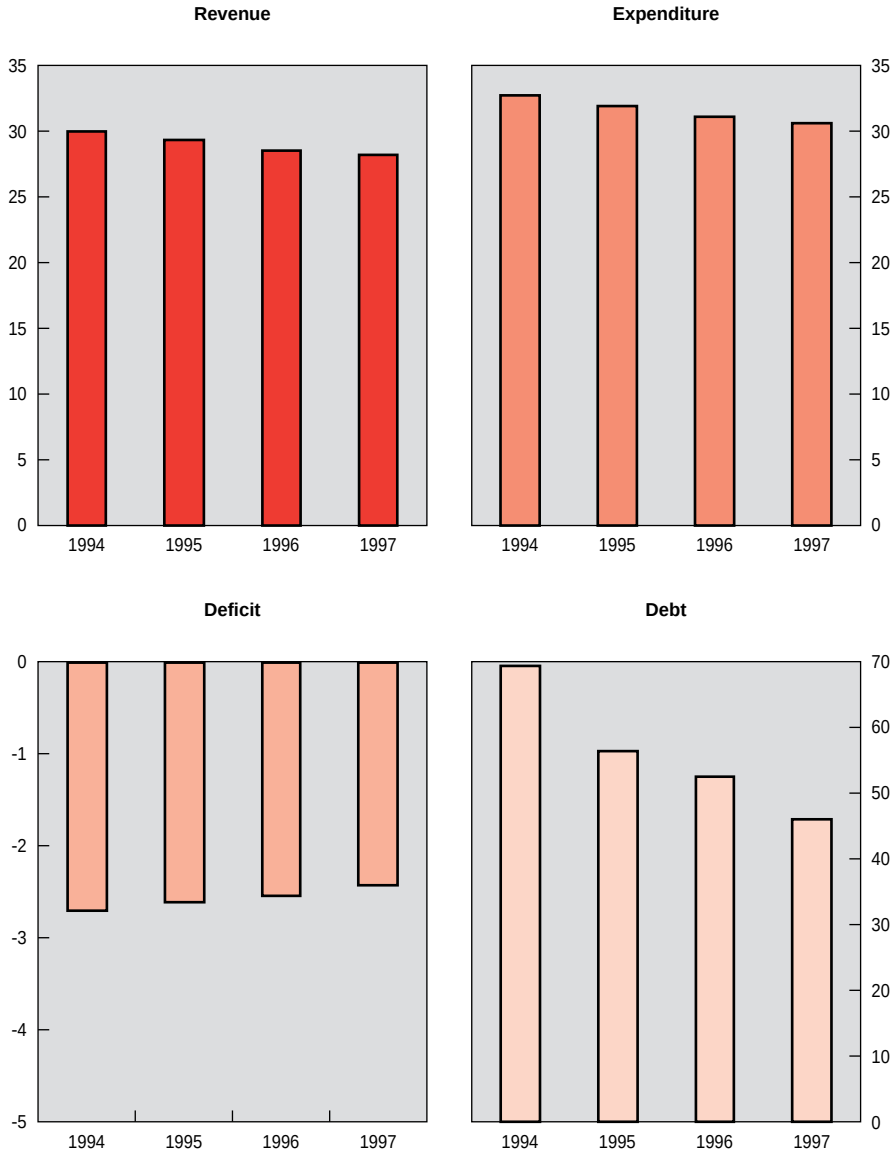
	1990	1991	1992	1993	1994	1995	1996[2]
Total revenue[1]	47.9	43.9	45.1	47.6	48.3	47.8	48.1
1. State budget							
Including transfers	34.8	26.1	27.2	29.5	30.0	29.3	29.1
Excluding transfers	34.8	25.9	27.1	29.4	30.0	29.2	29.1
2. Local budgets	. .	4.6	3.9	4.5	4.5	4.5	4.9
3. Extra-budgetary funds	11.3	10.4	10.9	10.5	10.8	11.0	11.5
4. State extra-budgetary units	1.8	1.9	1.6	1.5	1.4	1.4	1.0
5. Local extra-budgetary units	. .	0.9	1.7	1.8	1.6	1.7	1.5
Total expenditure[1]	45.1	45.8	50.0	49.9	50.5	49.7	50.9
1. State budget							
Including transfers	34.6	29.9	33.2	32.3	32.7	31.9	31.8
Excluding transfers	26.9	20.5	21.3	20.7	20.6	21.7	21.8
2. Local budgets	. .	4.3	4.2	4.6	5.4	5.4	6.2
3. Extra-budgetary funds	16.2	17.9	20.8	20.7	20.9	19.2	19.6
4. State extra-budgetary units	2.0	1.6	1.3	1.4	1.2	1.2	1.1
5. Local extra-budgetary units	. .	1.5	2.4	2.6	2.4	2.3	2.2
Total balance[1]	2.8	–2.0	–4.9	–2.3	–2.2	–1.8	–2.9
1. State budget							
Including transfers	0.2	–3.8	–6.0	–2.8	–2.7	–2.6	–2.8
Excluding transfers	7.9	5.4	5.8	8.7	9.3	7.6	7.3
2. Local budgets	. .	0.3	–0.3	–0.2	–1.0	–0.9	–1.3
3. Extra-budgetary funds	–5.0	–7.4	–9.9	–10.2	–10.1	–8.1	–8.1
4. State extra-budgetary units	–0.2	0.3	0.3	0.1	0.2	0.2	–0.1
5. Local extra-budgetary units	. .	–0.6	–0.7	–0.8	–0.7	–0.6	–0.7
Memorandum item:							
Nominal GDP (in billions of zlotys)	56.0	80.9	114.9	155.8	210.4	286.0	344.6

1. Excluding transfers between the state budget, local budgets, extra-budgetary funds and extra-budgetary units.
2. Budget projection.

Source: Ministry of Finance.

short run the expenditure side of the budget is less indexed than the revenue side. Fiscal intakes, however, did not rise as much as the size of the unexpected increase in nominal GDP might have suggested, since exports and investments, which are relatively lightly taxed, turned out to contribute more than projected to growth, and also as a result of tariff cuts and falling NBP profits. In the circumstances, the absence of a tangible improvement in the fiscal deficit in 1995, which would have helped mitigate the inflationary impact of money growth, was somewhat disappointing.

Figure 14. **FISCAL INDICATORS: STATE BUDGET**
In per cent of GDP



Source: Ministry of Finance; OECD projections.

The other general government bodies, after transfers from the state budget, displayed a small surplus, amounting to 0.5 per cent of GDP in 1994 and 0.8 per cent of GDP in 1995. Developments in this area are dominated by the finances of social security, which accounts for over two thirds of the general government expenditures incurred outside the state budget. While contributions were buoyed by the swift growth of the wage bill, outlays grew rapidly as well.

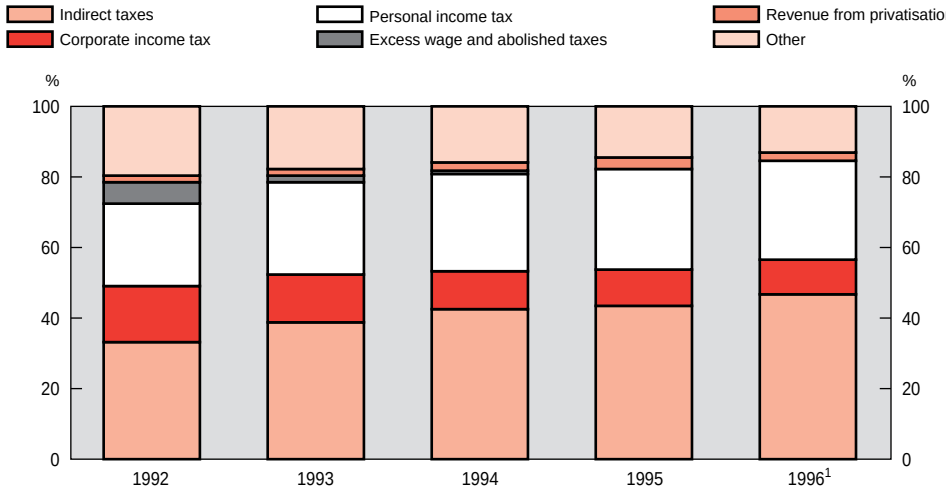
Fiscal decentralisation made some headway. A number of expenditures were in the process of being devolved from the central to the local level, with a view to improve efficiency by having decisions taken at administrative levels closer to the final expenditure point. In particular, a November 1995 law transferred a number of tasks – including road maintenance and the running of primary schools, social assistance facilities, local health care services, and local cultural institutions – from the centre to 46 large cities (in line with a pilot programme launched in 1994). The law also provided for the transfer of financial resources, *inter alia* in the form of the allocation to those cities of a share of the personal income tax.

Maintaining revenues

Maintaining fiscal revenues has been a major challenge in all countries in transition (International Monetary Fund, 1996). In Poland, tax revenues, non-tax revenues and social security contributions have been comparatively well maintained, notwithstanding widespread exemptions and large-scale arrears.

Tax revenues have increased slightly more rapidly than nominal GDP in 1994-95. Indirect taxes have grown much faster, with VAT receipts rising to 24.7 per cent of total revenues of the State budget by 1995, and excises to 14.5 per cent (Figure 15). Direct taxes, in contrast, rose more slowly, reflecting a marked decline in the contribution of corporate taxation, which more than offset the relative dynamism of personal income tax receipts. The share of corporate taxes in total revenue dropped from 13.6 per cent in 1993 to 10.6 per cent in 1995, despite the sharp rise in enterprise profits. Even though the statutory rate remained unchanged, at 40 per cent, the tax exemptions and deductions granted to encourage investment and exports led to a decline in the effective corporate income tax rate from 36.7 in 1993 to 32.6 per cent in 1995. The share of non-tax revenues (apart from privatisation receipts) continued to decrease, from 17.8 per cent in 1993 to 14.4 per cent by 1995, mainly reflecting a fall in the share of

Figure 15. **STRUCTURE OF STATE BUDGET REVENUES**



1. Budget law.
Source: Ministry of Finance.

customs duties, from 9.5 to 6.9 per cent, associated with the lowering of import tariffs and the increase in duty-free imports (Chapter IV). The share of revenues from privatisation, however, almost doubled, from 1.7 per cent in 1993 to 3.2 per cent in 1995 (Chapter II).

As in many other transition countries, substantial tax arrears emerged in Poland (Table 5).[22] Although the nominal stock of late payments to the state budget continued to increase somewhat in 1994-95, its value in real terms declined significantly. Expressed in months of tax receipts, arrears peaked at the end of 1993 at 1.7 and subsequently declined to 1.0 by end-1995. Besides the general improvement in corporate finances, one factor accounting for the decline in the stock of arrears has been the conditional cancellation of taxes due carried out on the basis of a Ministry of Finance directive of March 4, 1994. All taxpayers with arrears incurred between 1990 and 1993 under some already defunct laws were eligible. Partial cancellation was granted to debtors paying in a specified minimum amount (5 or 10 per cent depending on cases). The size of the cancellation was related to the timeliness of the payment: promptly paying in a

Table 5. **Arrears on taxes and social security contributions**

End-period stocks, million zlotys

	1990	1991	1992	1993	1994	1995
Nominal values						
Taxes [1]	620.0	2 830.0	3 630.0	5 223.3	5 650.4	6 009.4
Social security contributions	17.3	515.8	1 467.8	3 025.7	3 861.3	4 206.8
of which:						
State enterprises	17.1	348.2	1 237.9	2 595.2	3 107.5	3 150.0
Private enterprises	0.2	167.6	229.9	430.5	753.8	1 056.8
In real terms [2]						
Taxes [1]	620.0	1 764.3	1 568.3	1 640.0	1 370.0	1 198.2
Social security contributions	17.3	321.6	634.2	950.0	936.2	838.8
of which:						
State enterprises	17.1	217.1	534.8	814.9	753.4	628.1
Private enterprises	0.2	104.5	99.3	135.2	182.8	210.7
In relative terms						
Total tax and social security arrears (end-year stocks) in per cent of general government revenue (annual flows)	2.4	9.4	9.8	11.1	9.4	7.5

1. Including VAT, excises and dividends but excluding customs duties.
2. In December 1990 prices, using the CPI as a deflator.

Source: Ministry of Finance.

third of taxes due would result in complete cancellation of the tax liability. In 1994, 12 900 businesses took advantage of this debt reduction opportunity, of which some 90 per cent were unincorporated entities, resulting in the forgiveness of Zl 503 million in tax dues.

Arrears on social security contributions grew more rapidly than arrears to the state budget in 1994-95, but also declined in real terms. As a ratio to contributions paid, they peaked at 2.0 months at the end of 1993, but had fallen to 1.5 months by the end of 1995. Over a third of the arrears in late 1995 originated with the coal mines. The compression of the real stock of arrears reflected the general improvement in corporate finances but also large budgetary transfers to cover the overdue contributions of some SOEs, totalling Zl 0.8 billion in 1995, and budgeted at Zl 0.6 billion for 1996. In the absence of these transfers, the stock of arrears would still have shown an increase in real terms in 1995.

Tax evasion, pertaining both to taxes *stricto sensu* and social security contributions, has been undermining fiscal revenues. The Ministry of Finance identified implied losses to the state budget in 1995 amounting to Zl 3.2 billion, or 3.8 per cent of revenue (based on audits of 36 000 of the 2 135 000 registered companies and the checking of a fraction of the 24.6 million individual tax returns). Tax avoidance indeed constitutes one of the main motivations for business to be conducted underground, but it also concerns registered private as well as state-owned entities. One important measure taken in 1994 to alleviate the problem has been the introduction of a flat-rate income tax for individual entrepreneurs. The rates were set at relatively modest levels (7.5 per cent for services activities, 5.0 per cent for manufacturing, 2.5 per cent for retail trade and catering), and raised somewhat in 1995 (respectively to 8.5, 5.5 and 3.0 per cent). While such a system makes it impossible to cheat by reporting fictitious costs and reduces the administrative tax collection burden, it does penalise taxpayers actually incurring large costs. Another measure, which was envisaged for 1996, involved the recruitment of some 2 000 new tax inspectors. In addition, a law was passed by the Sejm in mid-1996 reinforcing the powers of tax inspectors and giving them easier access to bank records thus far protected by confidentiality rules.

Expenditure control

The acceleration of output in 1994-95 did not translate into a significant decline in the share of total fiscal outlays in GDP, which remained around 50 per cent. In part, this resulted from a surge in debt service payments, which rose from 11.9 per cent of state budget expenditures in 1993 to 13.4 per cent in 1994 and 15.7 per cent in 1995, in connection with the finalisation of the foreign debt rescheduling operations but even more so on account of domestic indebtedness. It also reflected the burden of pensions, which rose in line with GDP (Chapter III).

Average wages in the budgetary sphere continued to decline relative to wages in the enterprise sector in 1994, to 83 per cent (against 107 per cent in 1990) but recovered somewhat in 1995, to 85 per cent. At the same time, general government employment expanded by 1 per cent. The public-sector wage bill rose by 1.1 per cent in 1994 and 5.3 per cent in 1995 in real terms.

Expenditure pressures in 1994 and especially 1995 were not fully reflected in cash budget outcomes, as arrears built up, by 0.1 per cent and 0.4 per cent of

GDP respectively. As a result, the stock of expenditure arrears reached Zl 2.2 billion, or 0.8 per cent of GDP, at the end of 1995. The surge in arrears in 1995 was concentrated in education (unpaid social security contributions and heating bills) and health care (unpaid subsidies for medicines).[23] In the case of education, overruns stemmed from a larger than budgeted level of employment.

Deficits and debt

Even taking into account the remonetisation that took place in 1994-95, money balances are small in Poland: at the end of 1995, the ratio of zloty money to yearly GDP stood at 29 per cent, against 36 per cent in Hungary and 90 per cent in the Czech Republic. Therefore, a government borrowing requirement that may look moderate in per cent of GDP may still be high as a share of the money supply. *Ceteris paribus,* its monetisation will thus have a much larger inflationary impact in Poland. Under such circumstances, the containment of the deficit and the recourse to non-monetary financing sources are all the more important. The share of central bank financing of the deficit was brought down and the share of non-bank finance increased, for the first time exceeding that of bank finance in 1995 (Annex VI, Table A7).[24]

In 1994-95, the ratio of state debt to GDP shrank spectacularly, from 86 per cent at end-1993 to 70 per cent at end-1994 and 56 per cent at end-1995. Virtually all of the decline was attributable to the fall in the external component, from 63 to 46 to 35 per cent. The drop registered in 1994 was mostly the result of the implementation of the second stage of the Paris Club agreement and of the cancellation of close to half of the net present value of Poland's liabilities to commercial banks by the London Club (both described in the previous *Survey*). The direct, first-round impact of debt-forgiveness was to cut the debt to GDP ratio by close to 11 percentage points.[25] The sharp real appreciation of the zloty in 1995 was the main cause of the further decline of the debt ratio in that year.[26] Vigorous economic growth of course helped reduce the burden of both domestic and foreign debt.

At the same time, the structure of domestic public debt underwent considerable changes. In particular, the share held by the NBP declined sharply, from 38.8 per cent at end-1993 to 18.3 per cent at end-1995, and the share held by non-financial agents rose from 7.2 to 19.7 per cent. Simultaneously, efforts were

Table 6. **Structure of domestic marketable government debt**

End-year, in per cent unless noted

	1993	1994	1995	1996[1]
Instruments				
Treasury bills	55.9	59.8	53.9	48.7
Bonds	40.2	39.9	46.1	51.3
Zlotys denominated	5.1	12.0	25.3	35.0
Variable/floating rate	5.1	9.5	15.1	18.5
Variable	0.0	0.0	0.0	2.6
One-year indexed	3.5	5.1	6.7	3.8
3-year floating	1.6	4.4	7.3	10.4
10-year floating	0.0	0.0	1.1	1.7
Fixed rate	0.0	2.5	10.1	16.5
2-year	0.0	1.3	4.2	7.5
5-year	0.0	1.2	6.0	9.0
Denominated in foreign currencies	35.2	27.9	20.9	16.3
Other	3.9	0.3	0.0	0.0
Holders (domestic debt)				
NBP	35.0	30.1	8.7	7.6
Domestic commercial banks	59.3	55.1	67.8	68.2
Domestic non-bank sector	5.6	14.2	18.0	20.8
Non-residents	0.1	0.6	5.6	3.4
Memorandum items:				
Total marketable debt (Zl million)	27 809	36 207	43 886	58 113
Total public debt (Zl million)	133 976	146 211	160 700	190 330
Total public domestic debt (Zl million)	35 906	49 850	59 593	75 908
Total public foreign debt (Zl million)	98 070	96 361	101 107	114 422
Marketable debt as a share of total public debt	20.8	24.8	27.3	30.5

1. Budget projection.
Source: Ministry of Finance.

successfully made to lengthen maturities (Table 6). Until 1994, the longest fixed-rate instruments issued by the state had been 52-week T-bills. In February 1994, two and five-year fixed rate T-bonds were launched, and in December 1995, a ten-year floating rate T-bond was inaugurated. The willingness of buyers to purchase longer-term fixed rate paper signals that creditworthiness is improving and that disinflation is credible. A short-run consequence of the extension of maturities has been to postpone debt service payments, including interest charges, thereby improving current fiscal balances.

Progress was made with liquidity management. In 1995, the state deliberately sold more T-bills than strictly required for current needs, depositing excess balances with the NBP. Overfunding allowed the smoothing of the flow of T-bill

supply by enabling the Treasury to rely on withdrawals from its account at the time of disbursement peaks.

Even as the management of the visible public debt became more sophisticated, other forms of indebtedness, which are ill-monitored, were gaining importance. Cases in point include contingent debts and debts incurred by general government bodies other than the central budget. For example, following the rulings of the Constitutional Tribunal, the state somehow has to compensate pensioners and employees in the budgetary sphere for the incomplete indexation of their incomes in 1991-93. In early 1996, those obligations amounted to Zl 6.8 billion, inclusive of interest, *i.e.* more than 6 per cent of the planned 1996 state budget outlays and 1.9 per cent of GDP. Another example are credit guarantees issued by the state, which expanded rapidly in 1994. Although the stock declined somewhat in 1995, it totalled Zl 18.5 billion at the end of the year. Payments on account of such guarantees increased considerably in 1995, reaching Zl 279 million (0.1 per cent of GDP). Furthermore, as illustrated by the repeated capital injections into the BGZ bank over the past few years, the weaker state-owned businesses are likely to remain a drain on the budget in the future and in effect represent a net liability for the state (Chapter II). Besides, municipalities, state agencies, and state companies are increasingly contracting debts. For example, various cities have started to issue municipal bonds. The state budget might be affected if some of these entities turned out in future to be unable to service those debts.

The current situation, short-term prospects and risks

This section provides an update on economic developments in the first half of 1996, and projections through 1997. Some of the 1994-95 macroeconomic trends have lately shown marginal inflections but performance overall remained strong in the first half of 1996. The outlook for the next 18 months is still favourable, although somewhat less bright.

Recent developments

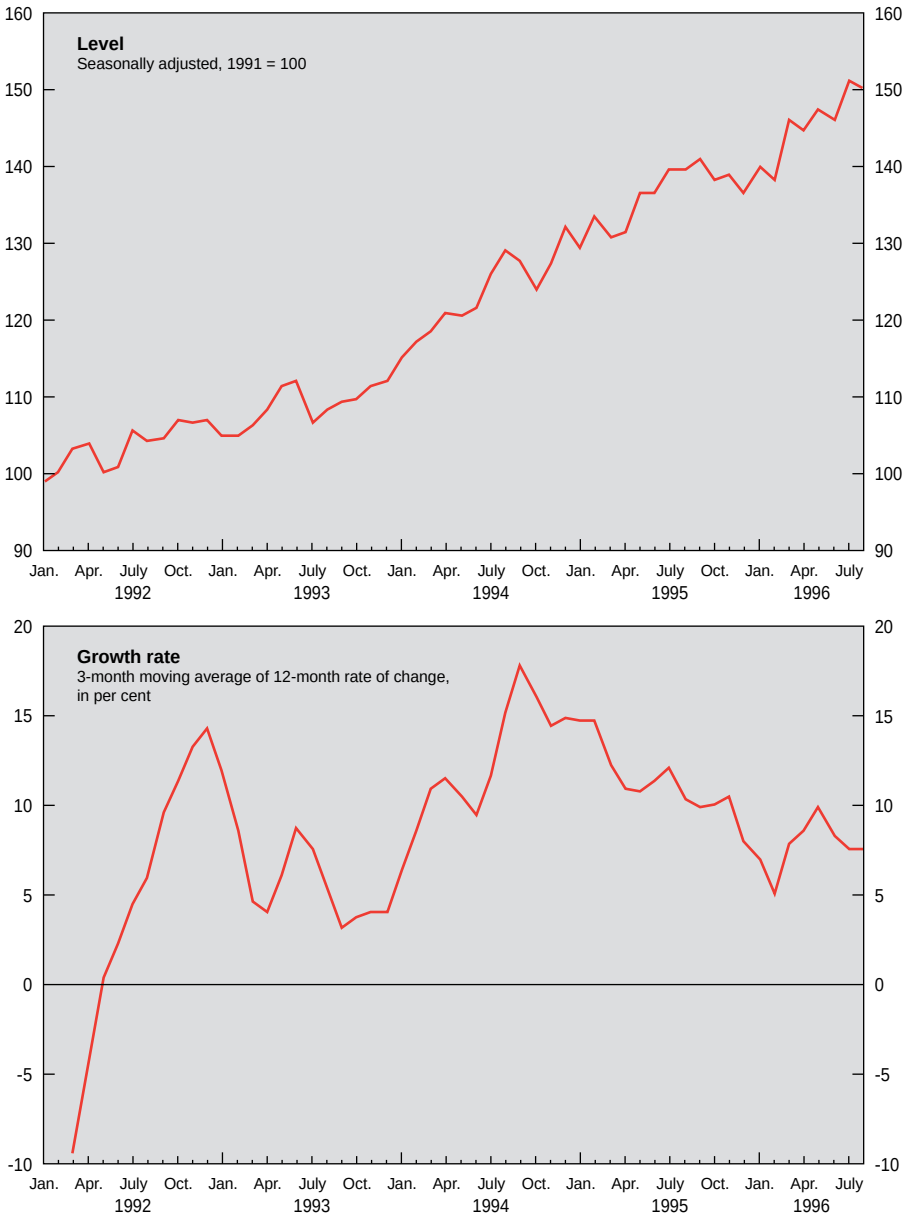
Growth may have peaked in the first half of 1995, when real GDP was rising at an estimated 7.3 per cent on a 12-month basis.[27] The rate of expansion abated to 6.8 per cent in the second half of 1995, and to 4.3 per cent in the first half

of 1996. On the supply side, the growth rate of gross industrial output over the previous year came down to 8.8 per cent in the first 8 months of 1996 from 11.5 per cent one year earlier (Figure 16). The level of activity in construction in early 1996 was affected by a relatively harsh winter. On the demand side, the deceleration was accompanied by a shift from net exports to domestic consumption and investment, reflecting anaemic export markets, significant import duty reductions, buoyant household incomes, substantial real exchange rate appreciation and dynamic investment. The average real wage in the enterprise sector was up almost 6 per cent in the first 8 months (suggesting that the nominal 21.8 per cent yearly ceiling set by the Tripartite Commission for 1996 might well be exceeded). The real effective exchange rate based on consumer prices was 11.2 per cent stronger in the first half of 1996 than one year earlier (the corresponding real effective exchange rate based on producer prices was up by 6.9 per cent). The volume of fixed investment outlays was 24 per cent higher, notwithstanding a slight deterioration in profitability ratios. Employment in the enterprise sector was down 1.3 per cent. Registered unemployment increased in early 1996, but declined during spring and summer, to 13.8 per cent of the labour force at the end of August (on a non seasonally-adjusted basis).

On the external side, the deficit on the recorded trade balance (on a cash basis) was up from $0.7 billion in the first 8 months of 1995 to $4.5 billion one year later, reflecting a marked slowdown in dollar export growth, from 38 to 6 per cent, and the stamina of dollar imports, the growth rate of which declined only from 40 to 30 per cent. The surplus on unclassified transactions barely increased, and the current account balance ended up in the black, but by a narrow margin.

Reserve accumulation continued at a brisk pace in early 1996, driven mainly by capital inflows, but subsequently slowed down. During the first quarter, net foreign direct investment inflows, on a cash basis, amounted to $0.8 billion, and net portfolio inflows to $0.6 billion. Correlatively, gross central bank reserves grew by 17.3 per cent, reaching $17.6 billion end-March. Net foreign assets increased by Zl 6.5 billion (13.2 per cent), *i.e.*, by more than broad money, which expanded by Zl 6.4 billion (6.1 per cent). In contrast, net foreign direct investment inflows slowed down to $0.4 billion in the second quarter, accompanied by a net portfolio investment outflow of $0.2 billion. Combined with a slowdown in short-term capital inflows and a turnaround in the current account balance, this

Figure 16. **INDUSTRIAL OUTPUT**



Source: Central Statistical Office, OECD.

translated into a very small increase in central bank reserves, by only $0.1 billion. Accordingly, the growth in net foreign assets slowed down to 3.6 per cent in the second quarter. Broad money, however, rose by 5.7 per cent, reflecting a pick up in net domestic assets, which expanded by 7.8 per cent. Partial and preliminary data through August suggest that this summer the impulse to money growth mainly stemmed from the domestic side.

In this context, further progress with disinflation was slow. The 12-month rate of change of the CPI dipped below the psychological 20 per cent barrier in May and June but again exceeded this symbolic threshold in July and August (reflecting a smaller seasonal decline in food prices in 1996). The PPI displayed a sharper deceleration, and was up 11.4 per cent by August 1996 compared to 20.5 per cent for the CPI. At the end of May, the Ministry of Finance proposed an anti-inflation package involving the minimisation of NBP financing of the budget deficit, caps on administrative price increases, the extension of duty-free imports of all grains until the end of the year, interventions on the food market and more wage restraint in SOEs. The package also included a cap on nominal salaries of top government officials, providing policy-makers with a private disinflation incentive. In mid-June, the government approved the main elements of the package, albeit with some amendments. In parallel, it was announced by the NBP and the Ministry of Finance that the real exchange rate would be kept essentially constant over the medium run but that in order to discourage short-run capital inflows more volatility was to be expected within the band at higher frequencies. Between January and May, intervention had ensured that the fixing rate remained some 2½ per cent stronger than the central parity. In June, the NBP let this spread narrow somewhat, to 1¾ per cent on average, and let the volatility of the exchange rate increase markedly. In July, reserve requirement rates on zloty demand deposits were cut from 20 to 17 per cent and headline NBP interest rates were reduced by 1 percentage point.

The budget law for 1996, passed by the Sejm and signed by the President in early February, set a rather unambitious deficit target of 2¾ per cent of GDP for the state (Table 4). It included a deficit of 0.1 per cent of GDP for the other components of general government, instead of the small surplus achieved in previous years. Among its distinguishing features was the decline in the share of spending on public debt service, for the first time since 1990. Emphasis was also put on investment in human capital (education, science, and health care), after

several years of severe restrictions, and in light of a tangible deterioration of service standards in those areas.[28] In accordance with this decision, salaries in the budgetary sphere were projected to rise faster in 1996 than in the enterprise sector. Also noteworthy was the sharp increase in transfers from the state to the local governments, in line with further devolution of expenditure assignments.

Preliminary information on the execution of the state budget in the first half shows income totalling Zl 43.9 billion and expenditure Zl 49.0 billion, resulting in a deficit of about 3 per cent of GDP. The latter was financed almost exclusively by the sale of Treasury paper to non-banks. Spending was boosted by large transfers to gminas (communes) and by the payment of Zl 0.5 billion in cash compensation to those pensioners who had not received the pension increase due in March 1992.[29] Worrying elements on the revenue side included the unexpected popularity and possible abuse of the tax deductibility of donations, and the lower-than-planned central bank profits and remittances to the budget. Offsetting these factors were the comfortable cash flow position of the Social Insurance Fund resulting from the rapid growth of the contribution bases, implying that no subsidies from the State budget were needed in the early months of 1996; and, on the revenue side, large privatisation intakes in the first quarter. At the general government level, the expenditures of the Labour Fund were running well ahead of plans, prompting an intensification of checks by the local labour offices in order to de-register the pseudo-unemployed.

Projections for 1996-97

Table 7 summarises the outcomes in 1994-95 and the Secretariat's projections for 1996-97.

Although 1996 might witness a slight deceleration, an expansion on the order of 5½ per cent, as foreseen in the budget law, can still be considered as the mid-point of the range of likely outcomes. The strength of investment since 1995, and the buoyancy of output and demand in the first half of 1996 suggest that in this regard the downside risk is limited. The 1996 harvest is expected to be below the propitious 1995 one, and a significant drop in agricultural value-added is probable, but given the share of this sector in GDP a poor crop would not cost more than half a percentage point in aggregate GDP growth. Beyond this year, output growth can be sustained around 5 per cent provided that policies remain

Table 7. **Summary of outcomes and projections**

Year-average real percentage change unless noted

	1994	1995	Projections	
			1996	1997
Real GDP	5.2	7.0	5.5	5
Consumption	3.9	4.1	6	4
Gross fixed investment	9.2	18.5	19.5	10
Exports of goods and non-factor services[1]	13.1	18.4	8.6	10
Imports of goods and non-factor services[1]	11.3	22.7	20.8	10
Current account balance: in US$ billion[1]	1.6	2.2	–0.5	–1.0
in per cent of GDP[1]	1.7	1.9	–0.4	–0.7
Employment	1.1	0.3	1.0	1.5
Registered unemployment (in per cent of the labour force, end-year)	16.0	14.9	14	13
CPI (end-year)	29.5	21.6	18	14
GDP deflator	28.4	27.0	20	15
General government (in per cent of GDP)				
Revenues[2]	48.3	47.8	48.1	48.2
Expenditures	50.5	49.7	50.6	50.6
Balance	–2.2	–1.8	–2.5	–2.4
Debt	69.5	56.2	52.4	46.0
Memorandum item:				
Nominal GDP (in Zl billion)	210.4	286.0	362.1	437.2

1. Including estimated unrecorded trade.
2. Including privatisation receipts.

Source: Central Statistical Office, Ministry of Finance, Secretariat's estimates and projections.

sufficiently supply-side friendly (see below) and that external demand does not weaken too much.

With the bulk of exports, both recorded and unrecorded, going to the EU, and over a third to Germany alone, there is a widespread perception of vulnerability of Polish exports and growth to the vagaries of aggregate demand developments in western Europe. The dynamism of export markets in general will certainly become an increasingly important determinant of export performance over the next few years, all the more as the supply from other transition countries develops. Moreover, the tax incentives provided to Polish exporters since 1994 may have imparted a permanent boost to the level of exports but cannot be expected to keep up their growth rate indefinitely. The same holds for once-and-for-all liberalisation measures. Export performance may still benefit from these factors in 1997, though, as they take time to work through. Lacklustre aggregate demand growth in Germany may hurt Polish producers less than German ones if

consumers, particularly in the eastern parts of the country, are inclined to switch further towards relatively cheap Polish goods, including in the form of still higher cross-border purchases. Furthermore, recent measures such as the expansion of the KUKE export credit insurance scheme may also help. For all these reasons, rapid growth of exports is projected to continue through 1997, supported by sustained productivity gains.

Imports are projected to rise briskly in 1996 as a whole, but in the absence of significant further real exchange rate appreciation,[30] their rate of growth is projected to converge to that of exports in 1997. The momentum of import growth over this horizon will be maintained in part by the scheduled cuts in import duties, by almost 5 percentage points in January 1997 (abolition of the import surcharge and cuts in line with the EU Agreement).

Unemployment is projected to decline very gradually. The positive impact of retirements and job creations will be partly offset by the arrival on the labour market of large cohorts of young people. The population of working age is expected to grow by 1.1 million in the second half of the 1990s, of which some 0.8 million are likely to enter the labour market. On that account alone, absorbing the entrants and reducing unemployment by one per cent per year would require the annual rate of growth in employment to pick up from its current lacklustre levels to around 2 per cent. Other factors bearing directly on the path of unemployment include possible shifts between hidden and open unemployment. In addition, restructuring in agriculture, mining and heavy industry would increase labour supply. Registered unemployment will also be sensitive to any change in registration rules or in the zeal with which they are implemented.

The target of the monetary authorities for 1996 CPI inflation is identical to the 1995 one, at 17 per cent. Up to the summer, inflation had not widely diverged from the monthly path underlying the official annual objective, which was not out of reach, although a slight overshooting seemed likely. Inflation expectations for 1996, however, remained sticky around 18-20 per cent, as attested by the latest polls of banks (September). Several factors will influence the outcome. One is the extent of real exchange rate appreciation: a monthly rate of crawl of 1.0 per cent translates into a 12.7 per cent annual rate, but the band provides significant flexibility even under an unchanged regime. A second is the size of the harvest and the effectiveness of the stabilisation operations of the Agricultural Market Agency. A third is the implementation of the scheduled administered price

increases. The liberalisation or not of fuel prices could also affect the outcome. For 1997, the government has announced a target of 13 per cent, on the way to single-digit inflation in 1998. Those targets are feasible provided that the stance of financial policies is prudent enough, and that serious reform of the pension system starts to be enacted, which would bolster national savings. Measures contributing to further de-indexation of nominal incomes would play an important role as well by limiting cost-push pressures.

The *Monetary Guidelines for 1996* published by the NBP in the fall of 1995 contained two scenarios. One involved a 24.2 per cent (Zl 25.3 billion) increase in the supply of broad money and a 19 per cent end-year CPI inflation rate, and the other a 28.5 per cent (Zl 29.8 billion) rise in money and 21 per cent inflation. In the event, the version approved by the Sejm in January 1996 included the 17 per cent inflation target that the Ministry of Finance had put forward in the context of the budget and a Zl 23 billion increase in the money supply. The latter objective, however, will most likely be exceeded. The implication for the inflation target is not straightforward, however. Money demand is still very low in Poland and could turn out to be higher than envisaged at the time the *Guidelines* were elaborated, provided that real interest rates remain attractive enough for the recovery of the propensity to save to continue. In that regard, and considering the prevailing adaptive blend of inflationary expectations, real *ex ante* interest rates do not seem overly high. For expectations to become more forward-looking, commonality of purpose among the two institutions in charge ought to be more visible than it was in 1995, when divergences of views on the appropriateness of the monetary policy mix were often voiced publicly at the top instead of being ironed out at a technical level. The record of co-operation between the NBP and the Ministry of Finance thus far in 1996 has been distinctly better, which should enhance the credibility of the policy framework.

On the fiscal front, the achievement of the 1996 budget deficit target as a percentage of GDP will be facilitated by the fact that nominal GDP is likely to exceed the figure underlying the budget by at least 5 per cent. Given the pressures on the monetary side and the modesty of the target, this bonus should not be spent but used to make faster progress this year with fiscal consolidation, while growth is still very robust.

The fiscal outlook beyond 1996 remains challenging. The scheduled elimination of the import surcharge and the cut in import duties will entail significant

revenue losses, even if the base continues to grow. Moreover, the government in April 1996 adopted *Package 2000*, a set of medium-term policy guidelines centred around a programme of tax cuts intended to help sustain the pace of investment and output growth.[31] The corporate tax rate was to be reduced by 2 percentage point each year starting in 1997, down to 32 per cent in 2000. In parallel, tax allowances for investment were to be restricted (although, at the same time, the associated minimum profitability eligibility criterion was to be relaxed so as to encourage job creation in high-unemployment areas). Personal income tax rates – which had been ''temporarily'' raised to 21, 33 and 45 per cent in 1994 but have remained there in 1995 and 1996 – were to be brought down to 20, 31 and 43 per cent in 1997 and restored to their pre-1994 levels of 20, 30 and 40 per cent in 1998. Capital gains were to remain tax-exempt until 2000.

The implied revenue shortfalls were to be offset and the tax regime streamlined by the reduction of the scope and generosity of tax expenditures. This is more difficult to push through, especially in view of the parliamentary elections forthcoming in 1997. For example, revenue intakes were to be strengthened by the concomitant expansion of the scope of the VAT, but raising the preferential VAT rates benefiting certain sectors met with fierce and partly successful resistance: the zero-rate on new housing sales and certain construction services, as well as on sales of unprocessed agricultural produce ended up being extended, as was the 7 per cent rate for construction materials. The objectives and constraints on the revenue side highlight the need to contain the growth and rationalise further the content of expenditures (Chapters II and III).

II. A new economy and some enduring features

The structure of the Polish economy underwent massive transformations during the first half of the 1990s. Frequent changes in government did not prevent this metamorphosis, but slowed down the speed of ownership transfer and of other institutional reforms. Enterprises and banks largely operate in accordance with market rules, but instances of government interference are not uncommon, not least when the state retains ownership control.

Political and administrative background

The average life span of a Polish government since 1989 has been one year. During the same period, the finance portfolio changed hands six times. Through 1995, disagreements surfaced between the presidency and Parliament on the constitutionality of a number of draft laws. Although these upheavals did not put into question the basic adherence to market-oriented policies, some key reforms were delayed, particularly as concerns privatisation and the pension system. Moreover, the perception of the authorities' commitment to reforms may have occasionally suffered.

The antagonisms within the executive branch and between the latter and the legislature partly resulted from political and personal differences. They also stemmed from the ambiguities contained in the so-called little (or interim) Constitution, passed in 1992. For instance, the delineation of powers between the President, the government and Parliament is not perfectly transparent, in particular with respect to budgetary deadlines. Also problematic is the fact that the Constitutional Tribunal is not endowed with autonomous powers to interpret the Constitution but is only entitled to decide on the constitutionality of specific actions, when seized. The right of the Sejm to override the rulings of the

Constitutional Tribunal is a further source of uncertainty. Work is underway on a new Constitution, and is likely to last at least until the end of 1996.

In parallel with the revision of the Constitution, proposals have long been under discussion on the reorganisation of the central government. In November 1995, the Council of Ministers approved a package of eleven laws reforming the ministries in charge of economic and financial affairs. The main objectives are to focus the attention of ministers on policy and regulatory issues, away from micro-management; to limit the intrusion of administrative organs in business life; to ensure a better co-ordination of medium-term policies; and to improve the quality of the professional civil service. Branch ministries would disappear. Economic policy would be conducted mainly by the Ministry of Finance and a new Ministry of Economy to be created by merging the Ministry of Foreign Economic Relations and the Ministry of Industry and Trade. The enterprise management functions of the founding bodies (ministries of Industry and Trade, of Transport and Maritime Economy, of Physical Planning and Construction, of Agriculture and Food Economy, of Culture and Art, of Health, etc.) would be transferred to the voivodships for some 1 300 small and medium-sized SOEs.[32] The Ministry of Privatisation would be closed down and a Privatisation Agency would be set up. A new Ministry of the Treasury would become the sole owner and manager of the remaining 150-200 larger SOEs. It would also handle the largest capital privatisation projects, and supervise the smaller-scale privatisation operations conducted by the Privatisation Agency. It is hoped that conflicts of authority between various public administration organs with respect to ownership functions would thereby be eliminated. The tasks of the Central Planning Office would be transferred to the Ministry of Economy and a Centre for Strategic Studies would be set up to conduct broad, long-term analyses. A cross-ministerial Integration Committee would co-ordinate work on the rapprochement with the European Union. In net terms, the number of ministers would be cut by two and governmental staff by about 5 per cent. The Sejm approved this scheme in June 1996 and implementation started in September.

The relations between central and local governments as well as the structure of the latter are also being reconsidered. An important reform effected early in the transition had been the creation of local self-governments, in the spirit of the principle of subsidiarity, *i.e.*, empowering local communities to deal with local issues. Further steps in this direction have been taken, for example with the

devolution of certain responsibilities to large cities (Chapter I). The envisaged creation of a cadastral real estate tax, with the receipts retained locally, would also contribute to strengthen the autonomy of the local authorities. At the same time, there is a debate on the appropriateness of the current set-up of 49 voivodships (regions) and 2 484 gminas (communes). The creation of a new level of local government – the poviats (counties) – was proposed in January 1994 by a group of opposition deputies. No consensus has emerged thus far on this issue. In the meantime, government members have floated various proposals, including one to reduce the number of voivodships to around one dozen ''macro-regions''. Final decisions on the number and powers of lower government levels are unlikely to be taken prior to the 1997 parliamentary elections.

Regarding monetary institutions, an important rampart in the consolidation of disinflation is a fairly independent central bank, as attested by international experience, including in transition economies (Loungani and Sheets, 1995). In that regard, some of the proposals to change the statutes of the NBP floated in 1995 caused some controversy. Two draft laws were under discussion in Parliament in early 1996. One is a draft law on the NBP, calling for monetary policy to be set by a council chaired by the NBP President. Three of the other members would be proposed by Parliament, three by the government and two by the association of commercial banks, and they would be nominated for fixed and staggered terms. The NBP board, also chaired by the NBP President, would execute the policies set by the council. Every year, the council would submit monetary policy guidelines to the Sejm for approval. The President of the NBP would be designated by the Sejm subject to the approval of the Prime Minister, and have a fixed six-year term. The other draft law pertains to banking supervision and would deprive the NBP of its responsibilities in this area, creating a new governmental agency to take over this function. At this relatively early stage of modern banking supervision, the transfer could be disruptive. It could also increase the scope for potential conflicts of interest as long as the state controls a large portion of bank shares. In addition, there is a serious risk of politicisation of banking supervision if the latter were to be placed under the aegis of the government. Some of the provisions of the first draft law were perceived by the NBP as threatening its independence. In principle, the credibility of the disinflation efforts would indeed suffer if the independence of the central bank were to be compromised.

In April 1996, however, the Sejm committee working on the draft of a new Constitution reached agreement on a set of articles providing a fairly solid institutional background for sound financial policies. The draft stipulates that if the ratio of public debt to GDP were to exceed 60 per cent, the Council of Ministers has to come up with measures that would bring it back below that threshold. It also prohibits NBP financing of the deficit. Moreover, it includes a series of articles on NBP governance that would guarantee central bank independence more firmly than is the case in the aforementioned draft law.

Supply, demand and price shifts

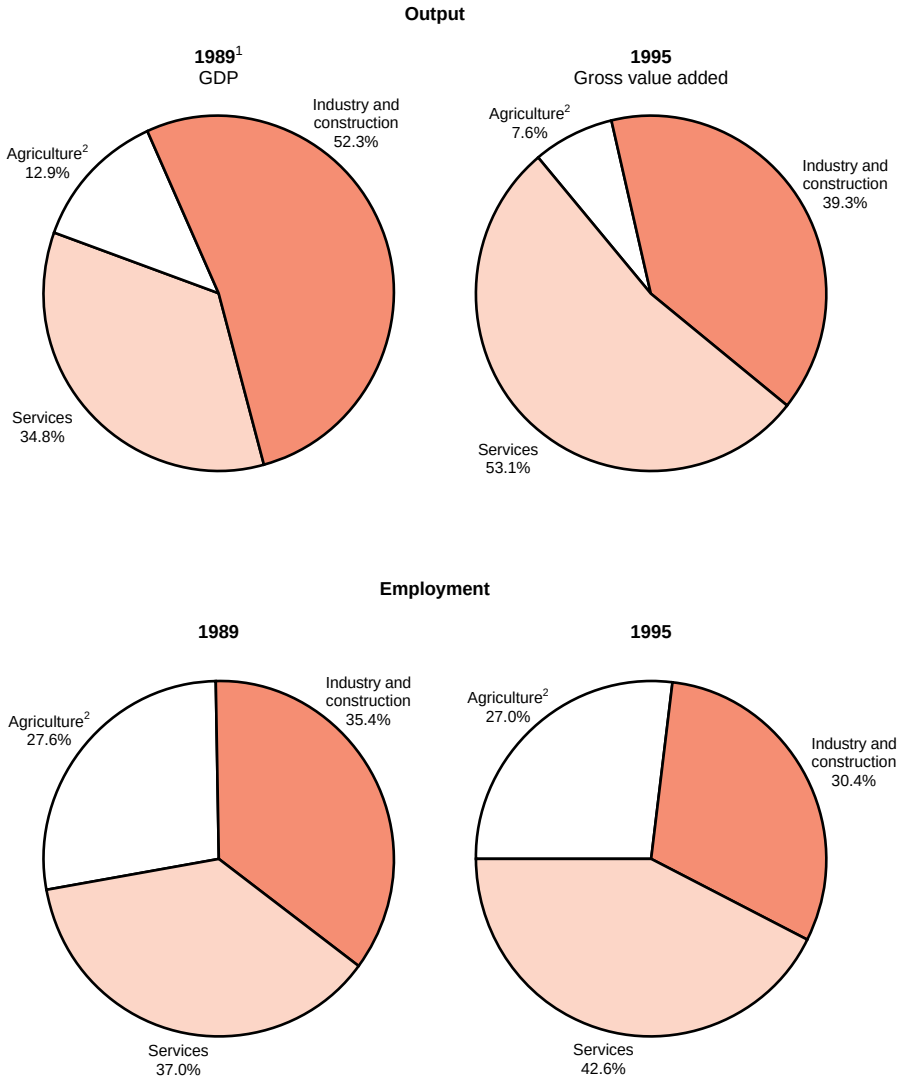
Between 1989 and 1995, the physionomy of the Polish economy changed radically. This section briefly characterises the permanent shifts that occurred on the supply as well as on the demand side, and the price changes that resulted from comprehensive liberalisation. These metamorphoses render seemingly natural comparisons of welfare and performance over time rather hazardous (Chapter III).

Production

The structure of the supply side changed considerably during the first half of the 1990s, largely due to shifts in relative prices (see below). At the broadest level, the share of services in output soared from 35 to 53 per cent, while that of industry declined from 44 to 33 per cent (Figure 17).[33] The share of agriculture fell from 13 per cent in 1989 to 8 per cent in 1995. By 1995, the share of services was still well below the OECD average of about two thirds, on a par with Turkey's. The share of agriculture stood at about the same level as in New Zealand, Ireland or Portugal.

The decline in value-added was relatively larger in industry in 1990-91 and the subsequent recovery swifter. At a more disaggregated level, the relative importance of the various branches within industry *lato sensu* underwent durable changes. For example, the share of mining and quarrying plummeted between 1989 and 1995, from 13 to 5 per cent. Looking at some more extreme cases, the output of radios and tape-recorders declined cumulatively by more than 90 per cent, whereas that of furniture rose by 48 per cent. Even in those branches where output recovered after an initial drop (*e.g.*, steel and shipbuilding), the

Figure 17. **SECTORAL SHARES IN OUTPUT AND EMPLOYMENT**
In per cent of total



1. According to the 1968 System of National Accounts.
2. Including forestry, fishing and hunting.

Source: Central Statistical Office.

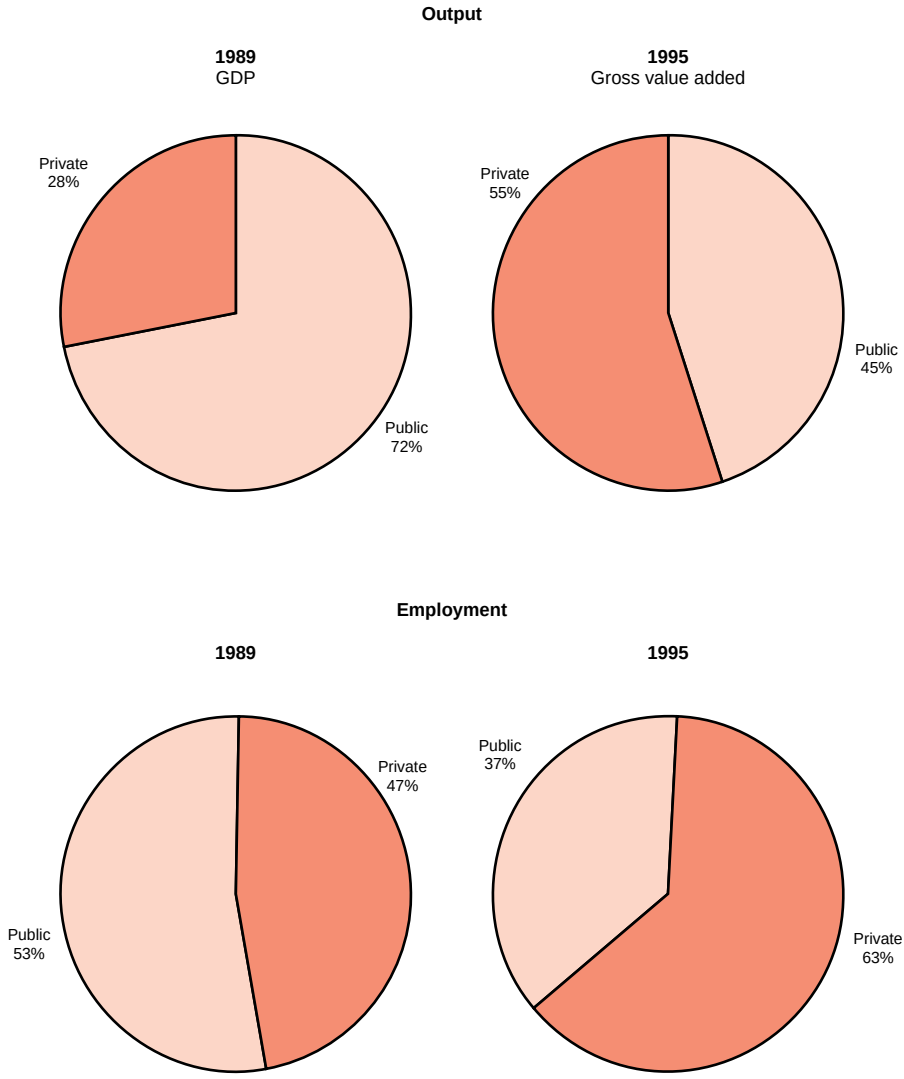
assortment of products and their quality (broadly defined, *i.e.*, including for instance timeliness of delivery) had changed considerably.

Employment shares did not move quite in the same way, reflecting disparate productivity developments (Figure 17). At the broadest level, the share of industry declined by 5 percentage points, and that of services rose by almost 6 percentage points. The most rapid increases in the expanding service sector were recorded in branches such as trade and financial services. The share of employment in agriculture shrank, but by less than one percentage point. In 1995, agriculture thus continued to employ more than a quarter of the total labour force, compared with 10 to 13 per cent in New Zealand, Ireland and Portugal. The gap between comparative shares in value-added and in employment may partly reflect the fact that Polish farmers on average spend more time working outside agriculture, but results primarily from the low average productivity of Polish agriculture (Annex I).

Turning to the structure of supply by ownership types, the share of the private sector doubled over the period under consideration, from 28 per cent in 1989 to 55 per cent in 1995 (Figure 18).[34] It had thus regained most of the ground lost under central planning.[35] On the employment side, the share of private activity rose less, from 47 per cent in 1989 to 63 per cent in 1995 (Figure 18). Indeed, employment in agriculture had always remained predominantly private, contributing to the high share of private employment in the base year. Again, large sectoral variations were observed. For example, by 1995, the share of private enterprises amounted to 42 per cent in total industrial production, but to 87 per cent in construction. In trade, 93 per cent of turnover was generated by private firms. Even in traditionally wholly public services such as health care and education, the share of private providers is no longer trivial. Thus, by 1994-95, 4 per cent of secondary school pupils and 7 per cent of university students attended private establishments.

The change in the composition of output and the increase in the role of private entities to a large extent reflected the dynamism of new private firms, particularly smaller ones. The number of businesses soared in the early 1990s, helped by relatively liberal rules governing the establishment of new ventures. The pace of net creations subsequently slowed down somewhat. In 1994-95, some 20 to 30 thousand new entities sprung up every month, while some 10 to 25 thousand disappeared.[36] At the end of 1995, the Polish economy counted

Figure 18. **SHARE OF THE PRIVATE SECTOR**
In per cent of total



Source: Central Statistical Office.

around 2 million enterprises. The greater vitality of smaller and leaner firms has translated into a decline of the relative importance of bigger ones. In industry, the share in sales of large enterprises (defined as employing more than 500 workers) dropped from 83 per cent in 1989 to 74 per cent in 1994.

Demand

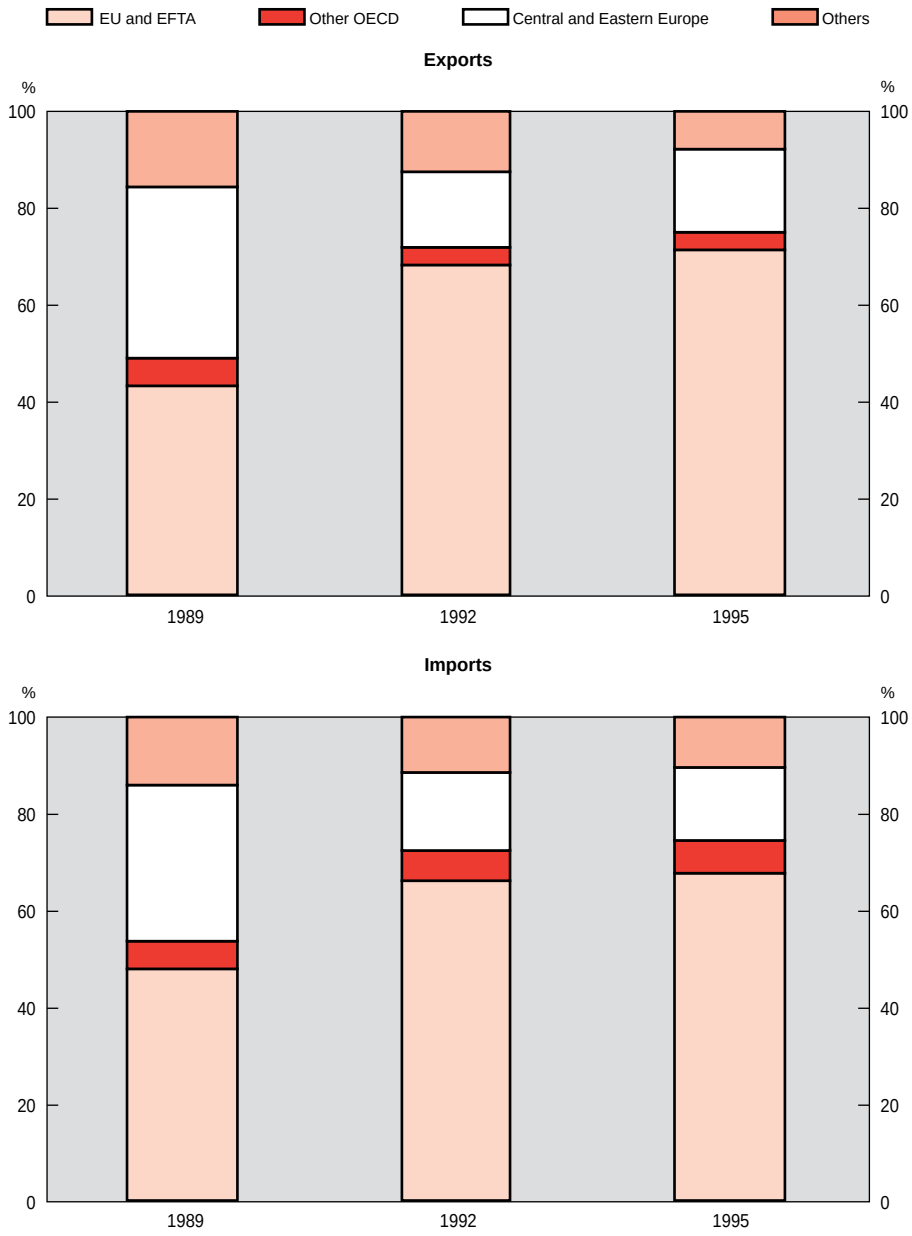
The recomposition of output has reflected the change in the nature and content of demand. State orders, rationing through official channels and partly compensatory transactions in shadow markets ceased. Likewise, the rules governing foreign trade were completely overhauled, giving rise to new export and import potentials, and confronting domestic producers with heightened competitive pressures.

Among domestic components of aggregate demand, a major shift involved the rebalancing of investment and consumption. At current prices, the share of gross fixed capital formation in GDP declined from 22 per cent in the mid-1980s to about 17 per cent in 1995, and that of stockbuilding from 7 to 1 per cent, while the share of total consumption expanded from 70 to 81 per cent.[37] To some extent, the contraction in the share of total investment was the manifestation of a permanent shift from an inefficient regime of over-accumulation of capital and repressed consumption to a less constrained and more balanced one. Even so, the share of fixed investment as of 1995 remained on the low side and is indeed projected to rise further (Chapter I).[38]

Consumption patterns also changed a lot, as the choice sets faced by consumers expanded. Within household consumption, the assortment of foods purchased underwent major changes. At the same time, the share of housing, commuting and health care expenditures increased sharply, reflecting the commercialisation of heretofore heavily subsidised or simply public services.

The share of foreign trade in GDP increased significantly between 1989 and 1995, with exports of goods and services rising from 19 to 25 per cent and imports from 15 to 23 per cent on a national accounts basis.[39] Import penetration in industry doubled, with imports rising from 14½ per cent of industrial sales in 1989 to 29 per cent in 1995, while the share of exports in industrial sales increased from 14 to 22½ per cent. At the same time, dramatic changes occurred in the direction and content of external trade.

Figure 19. **DIRECTION OF FOREIGN TRADE**



Source: Central Statistical Office.

Geographically, the lifting of the corset imposed by the Council for Mutual Economic Assistance (CMEA) and the recessions in the other transition countries prompted a massive switch from East to West. Roughly speaking, the share of trade with OECD countries rose from one half to three quarters, while that with other countries of Central and Eastern Europe, which stood at about one third in 1989, halved (Figure 19). The share of the rest of the world also declined. Although trade with other transition countries did see a revival starting around 1994, most of the re-orientation that took place in the early 1990s can be interpreted as of a lasting nature.

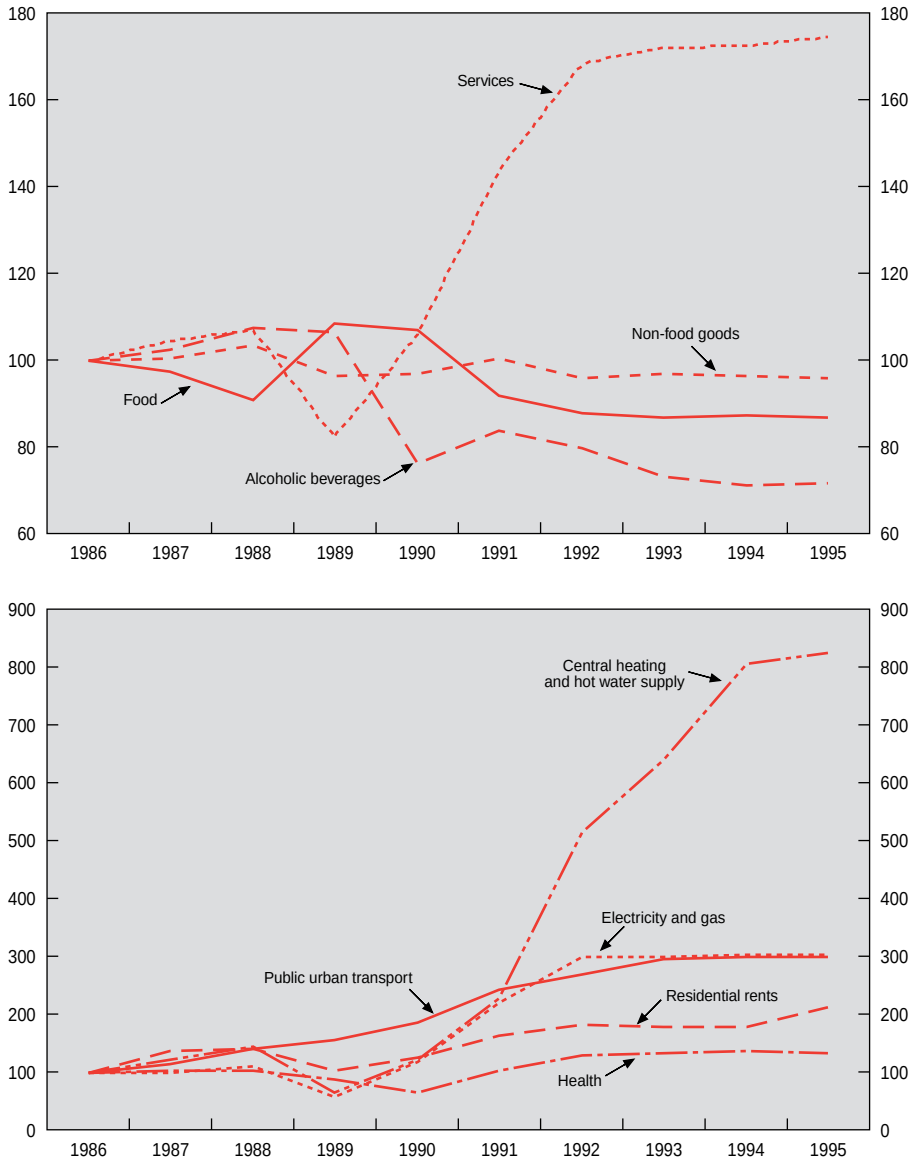
The composition of trade flows also changed considerably during the first half of the 1990s. Based on a classification of goods according to the 21 lines of the EU combined nomenclature, the share of natural resource intensive exports declined (to 45 per cent). So did the share of exports embodying a relatively large proportion of skilled labour, capital and technology (to 30 per cent). Correlatively, the share of exports intensive in low-skill labour rose by some 10 percentage points, consistent with the increasing importance of outward processing (Chapter I).[40] Illustrative of this trend are a steep drop in the share of electro-engineering exports (possibly resulting from the collapse of the CMEA) and a sharp rise of light industry exports. On the import side, the share of natural resource intensive purchases dropped by 7 percentage points. The share of imports intensive in skilled labour, capital and technology remained stable, at close to one half. That of imports intensive in low-skilled labour increased by close to 10 percentage points, to 15 per cent. On this very aggregated basis, Poland by 1995 had a revealed comparative advantage in sectors intensive in low-skilled labour and natural resources.[41]

Prices

The macroeconomic imbalances that built up in the 1980s in Poland caused inflation to take off even as a large proportion of prices was still administered. Comprehensive liberalisation took place in two main steps, for most food products in August 1989 and for most other prices in January 1990. The prices of some items, notably energy carriers and selected services, were not freed but adjusted administratively.

Large-scale decontrol almost instantly eliminated queuing and caused major relative price realignments (Figure 20). Subsequently, further adjustments in

Figure 20. **LONG-RUN PRICE DEVELOPMENTS**
Relative prices, 1986 =100



Source: Central Statistical Office.

administered prices and taxes aimed at bringing prices closer to cost-recovery levels and pushed the structure of relative prices closer to that prevailing in neighbouring market economies. This translated into a ''catch-up'' in the relative price of services, as in almost all other transition countries (De Masi and Koen, 1996).[42]

As of early 1996, a number of prices remained administered or otherwise regulated (as was long the case in some OECD countries). Prices administered centrally included, at the producer level, natural gas and electricity, and at the retail level, heating for flats, natural gas, electricity, some medicines and health care services, and spirits. Locally, direct controls and attendant subsidisation were still widespread as concerns rents for flats, charges for cold water and sewage, and public transportation. There were also more indirect regulation mechanisms, in the form of the obligation for 36 monopolies to notify the authorities 21 days in advance of the intention to raise prices, which applied for example to fuels, artificial fertilisers and some medicines. The Anti-Monopoly Office monitors price-setting by enterprises deemed to have significant market power.

Even if administered prices were generally increased much faster than other prices, some of them, particularly for housing and related services, remained far below market levels several years into the transition. As such, they are an important component of the social safety net, albeit an inadequately targeted one (Chapter III).

In sum, looking at broad structural proportions, Poland has overall moved a long way toward relevant OECD comparator countries. More signs of inertia, however, can be detected at the microeconomic level.

Privatisation and commercialisation

The divestiture of state ownership and control has been a complex and relatively slow process, partly due to intense political struggles over the implied redistribution of rights between stakeholders (workers, managers, bureaucrats and politicians) but also because it has been a voluntary process, meaning that insiders have had a veto power. Delays purportedly have also reflected a concern not to sell assets too cheaply. Privatisation has followed many simultaneous

tracks, leaving almost no option unexplored. Governance failures have not necessarily been ameliorated by privatisation, as insiders have often retained too much influence, at the expense of potential strategic outside investors. Notwithstanding the scope of the privatisation programme for the second half of the 1990s, the state is likely to remain the single most important decision-maker in many enterprises and sectors in the foreseeable future.

Alternative tracks

Privatisation has been proceeding along three main routes. The first one, under the heading of direct privatisation or liquidation, covers small and medium-sized enterprises. The second route, usually referred to as indirect or capital privatisation, concerns larger firms, and involves open sales of shares and the search for a strategic outside investor. The third route, mass privatisation, is meant to distribute ownership rights to all citizens. It started only recently, and on a fairly limited scale. In addition, a number of SOEs have been commercialised, *i.e.*, transformed into wholly-state-owned joint-stock companies. The modalities of ownership transfer in the first two routes were described at length in the previous *Surveys*, while the architecture and implementation of the mass privatisation programme are presented in Annex IV. This section is therefore confined to an overview of recent privatisation and commercialisation developments.[43]

By the end of 1995, privatisation or commercialisation had been initiated in less than half of the SOEs that existed in 1990, when the process was started, and privatisation had been completed in less than 20 per cent of cases (Table 8).[44] Even in the latter, the state has sometimes retained a substantial proportion of shares, remaining the controlling shareholder.

Direct privatisation has followed two tracks. A substantial portion of enterprises were subjected to Article 37 of the 1990 Privatisation Law, the assets and liabilities often being leased to insiders, as the first step towards an eventual purchase. This method strengthens the control of the enterprise by workers and management. A large number of enterprises in poor financial condition were liquidated in accordance with the provisions of Article 19 of the 1981 Law on State-Owned Enterprises, the assets being mainly sold to private entrepreneurs. This has proved an efficient way to put idle productive capacity back into use. The sale of immobile and social assets, however, has been more difficult and, as

Table 8. **Progress of ownership transfer**

	1990	1991	1992	1993	1994	1995	First half 1996
Number of enterprises (cumulative stance at end-period)							
Total number of state-owned enterprises [1]	8 453	8 228	7 245	5 924	4 955	4 357	4 081
Bankruptcy (Article 19 of the SOE Law)							
Started	18	540	857	1 082	1 245	1 358	1 401
Completed	0	19	86	186	303	396	478
Direct privatisation (Article 37 of the Privatisation Law)							
Started	31	449	719	917	1 042	1 149	1 223
Completed	0	182	475	707	945	1 054	1 138
Converted into joint-stock companies	38	260	480	527	723	958	1 049
NIF-programme	0	0	0	0	0	321	512
Capital privatisation	6	27	51	96	147	219	248
Public offerings	5	11	12	15	19	22	22
Trade sales	1	16	39	81	110	132	140
Mixed methods	0	0	0	0	3	5	6
Tenders	0	0	0	0	0	0	2
Debt-equity swaps	0	0	0	0	15	60	78
Total							
Started [2]	87	1 249	2 056	2 526	3 010	3 465	3 673
Completed	6	228	612	989	1 395	1 669	1 864
Income from privatisation (flows, in Zl million)							
Total		170.9	484.4	780.4	1 594.8	2 641.7	1 406.9
Leasing and sale of liquidated assets		46.4	171.8	287.0	322.9	406.2	186.8
Capital privatisation		124.5	308.7	439.4	846.7	1 714.2	1 094.9
Bank privatisation		0.0	3.9	54.0	425.2	521.3	125.2

1. Central Statistical Office series.
2. Excluding capital privatisation operations (which appear only on completion in this table).

Source: Ministry of Privatisation, Ministry of Finance, Central Statistical Office.

evident from Table 8, this type of liquidation procedure usually takes several years to be completed. Capital privatisation has been the main source of revenue for the budget even though it concerned a much smaller number of firms. In 1994-95, the scope of capital privatisation increased, extending notably to the tobacco industry. Many deals involved foreign buyers, who in 1995 accounted for two thirds of the revenue from capital privatisation. In a number of cases, the outsider investor had to offer employment or wage guarantees to the incumbent workforce. Lastly, a growing share of income from ownership transfer is coming from bank privatisation, which is discussed further below.

Assessing the merits of alternative privatisation methods with respect to corporate governance is complicated by potential selection biases: it cannot be ruled out that post-privatisation performance was superior under one or the other scheme because the pool of firms covered by the latter was better to begin with. Nevertheless, a conclusion reached in many surveys is that the most impressive improvements in enterprise performance were obtained through capital privatisation, especially when it involved foreign investment.[45] Two of the advantages of this mode of ownership transfer are that it brings in an outsider motivated by the firm's future results rather than by the protection of insiders' rents, and that it is often accompanied by a significant injection of fresh human, physical and financial capital. It should also be noted that some new private firms started operations with assets that formerly belonged to SOEs, and have prospered. In such cases, asset if not enterprise privatisation has turned out to be very successful as well.

Legislative hurdles

In September 1996, and after three years of tempestuous discussions and negotiations (including a presidential veto of an earlier draft in mid-1995, overruled by Parliament, and followed by a recourse to the Constitutional Tribunal), a Law on the Commercialisation and Privatisation of State-Owned Enterprises was promulgated. The Law does not alter the basic principles of multi-track privatisation but does include some new rules.

The Law continues to provide for the commercialisation of large SOEs slated for subsequent privatisation, but the consent of enterprise insiders is not required any more. Such commercialisation involves the abolition of the workers' council as a management body, depriving it of the ability to block privatisation. A new option is commercialisation without subsequent privatisation, applicable

in particular to enterprises requiring restructuring. In this case, commercialisation is to be decided by the government as a collective entity rather than by the Ministry of Privatisation. This option creates the risk of entrenching founding bodies in the role of permanent holding companies for many SOEs. For SOEs in poor financial shape, the Law introduces the option of commercialisation through debt-equity swaps. The Law foresees that the privatisation of ''strategic'' enterprises (to be identified in an ordinance of the Council of Ministers) will also be subjected to the approval of the government as a whole. The Law further stipulates that employees of enterprises undergoing privatisation are to be given up to 15 per cent of the shares free of charge, as compared to their right under the 1990 Law to buy 20 per cent of the stock at half price. In addition, at least 5 per cent of the shares of commercialised firms are to be set aside for use in the context of social security reform (see below). The Law also allows new waves of privatisation vouchers (distinct from the current mass privatisation programme). During the prolongued gestation period of the Law, the existing legislation, which enabled enterprise insiders to block privatisation, remained in force. Privatisation may have been retarded in some enterprises by insiders waiting for the new law and its more generous provisions on the allocation of shares to come into being.

Decisions are still pending on other dimensions of privatisation. In particular, compensation vouchers or shares in state-owned banks might be allotted to old-age and disability pensioners and public sector employees in order to make up in part for the incomplete income indexation in 1991-93 which the Constitutional Tribunal ruled against (Chapter I). Restitution vouchers rather than in-kind restitution are envisaged in the latest draft law on ''re-privatisation'' to compensate the former owners of property nationalised between 1944 and 1962 in violation of the legislation then in force. Thus far, 5 per cent of the capital of the firms undergoing indirect privatisation has been set aside for restitution purposes. As long as no restitution law is passed, the ownership status of all property on which re-privatisation claims exist will remain in doubt, deterring potential buyers. Moreover, an increasing number of nationalisation decisions are being annulled by the Supreme Administrative Court, putting the state in a delicate position.

The fate of privatisation is also linked to that of social security reform since it has been proposed to contribute shares of state-owned banks or enterprises to the initial capital of the envisaged pension funds (Chapter III). Although it is

laudable in principle to exploit complementarities between the needed structural reforms, it may in current circumstances result in compounded delays.

Further privatisation

Ownership transfer in 1996 was expected to involve the initiation of the direct privatisation of some 150-200 enterprises and an acceleration of capital privatisation, which would embrace some 90 firms, including a number of very large ones such as Polish Airlines (LOT), the Katowice Steel Mill, and, late in the year or early next, the copper producer Polska Miedz (the latter would constitute one of the biggest privatisation deals in Central and Eastern Europe). Capital privatisation in 1996 was also scheduled to encompass firms in the chemical, pharmaceutical, food, machinery, building materials and trade sectors. In many cases, however, less than half of the shares of the enterprise are to be sold. Capital privatisation was to be facilitated by the use of a quicker, streamlined, written tender procedure launched in May.[46] During the first half of 1996, bankruptcies were initiated in 43 firms and direct privatisation in 74, capital privatisation was carried out in 29, while 91 enterprises were commercialised (Table 8). It appeared that the capital privatisation of the largest companies might fall behind schedule, with preparations for public offerings turning out to be more time-consuming than originally envisaged.

Another innovation is the decentralisation of direct privatisation. The regional offices of the Ministry of Privatisation have been put in charge of liquidations, with a view to expedite procedures. A risk is that local interests might now be in a better position to exert pressure on the relevant privatisation authorities.

Discussions are also ongoing within and between the relevant ministries on the creation of a new brand of sectoral funds with a view to speed up restructuring and privatisation in heavy industry. Each fund would be endowed with a set of companies in a certain sector and issue certificates which would be distributed for example to the inhabitants of the region where the companies are located. The funds are meant as local and sectoral replica of the national investment funds central in the mass privatisation programme (Annex IV), but could in practice end up resembling insider-controlled holdings.

On current plans, privatisation in 1997 would concern steel (32 enterprises), textiles (42 enterprises), sugar (4 holdings and 65 plants), spirits (21 enterprises),

energy distribution (20 enterprises), construction (26 enterprises) and telecommunications. In 1998, privatisation would extend to the defence, petrochemical and municipal service sectors (in some cities, though, parts of the water and sewage infrastructure have already been privatised, and private waste collection has started). Privatisation in 1999 would include *inter alia* firms in the heating, road transport and health care sectors. On the one hand, this sectoral list suggests that privatisation may not have been as swift as could have been possible: for instance, it is not clear what is holding up the exit of the state from road transport activities. On the other hand, it should be recognised that privatisation as envisaged would embrace sectors that have long remained in the public sphere in western European countries.

The residual state sector

Among the sectors partly or completely excluded from the above privatisation plans are postal services, railways, sea and air-ports, oil and gas pipelines and mining. Some of those can be considered as natural monopolies, although that does not necessarily imply that state ownership is optimal. Others, such as mining, clearly do not fall in that category in the first place. Presently, however, ownership in many more sectors is still dominated by the state, subjecting firms to the tutelage of some central or regional administrations.

Quantifying the extent of effective state control is virtually impossible, as the market value of state shares is largely unknown and as the threshold for effective control varies across firms and over time. In addition, the state may in practice actively exercise its control rights or in contrast adopt a hands-off posture. Nevertheless, some indirect measures illustrate the magnitude of potential state influence. As of November 1995, the book value of state shares in production, trade, service and financial entities amounted to some Zl 142 billion, which compares with a capitalisation of the companies listed on the Warsaw Stock Exchange of Zl 8 billion.[47] The role of the state is particularly important in large enterprises: in 1995, 19 of the largest 100 Polish companies were SOEs, 35 were wholly-state-owned joint-stock companies, and 17 were concerns with ''mixed'' ownership dominated by state-owned shareholders. Many of these sizeable enterprises were concentrated in and around heavy industry (Table 9).

A number of the state-controlled firms are generating losses and many more are in dire need of deep restructuring. It has often been argued that privatisation

Table 9. **Public sector enterprises**[1]

Percentage shares in 1995

	Of all enterprises in the sector		Of all public enterprises	
	Number	Value of production	Number	Value of production
Total	6.3	48.3	100.0	100.0
of which:				
Manufacturing	6.6	47.1	39.2	48.9
Mining and quarrying	38.3	97.1	1.8	11.0
Electricity, gas and water supply	77.7	98.0	7.5	13.6
Construction	4.8	17.4	12.5	2.9
Services	4.5	36.9	32.5	22.1

1. Only enterprises with more than 5 employees.
Source: Central Statistical Office.

would not be desirable prior to restructuring, on the grounds that the current owner and managers are in a better position to save the enterprise in the short run, and to prepare it for subsequent privatisation for a high price. The current condition of those enterprises casts doubts on this line of reasoning, even though state support certainly has ensured the survival of certain entities.

One way to help out weaker state-controlled firms is the creation of holdings, which have been proposed in particular in the coal, shipbuilding, steel, oil, pharmaceuticals, sugar and spirits industries.[48] Exploiting synergies is desirable in principle, and the emergence of larger entities could indeed help withstand the present and forthcoming pressures of foreign competition. At the same time, holding schemes are sometimes imposed from above on reluctant firms. They also serve as an instrument for off-budget, and hence less transparent, cross-subsidisation, as pointed out by the Anti-Monopoly Office (AMO) in the case of coal mines.[49] Holdings tend to weaken competition among domestic producers, as emphasised by the AMO in the case of the sugar industry. This is all the more the case when they are sheltered by the foreign trade regime. The creation of the giant oil concern Nafta Polska, in April 1996, is also worrisome in that respect. Furthermore, when setting up or expanding holdings involves the acquisition by state-controlled companies of firms undergoing privatisation, as was the case in 1995 with the purchase by the trading company Impexmetal of the Konin aluminium smelter, there is a risk of rampant re-nationalisation. For this reason,

among others, privatisation of the holding should be a priority. Finally, holdings may reinforce the opposition to restructuring by giving more clout to subsidised firms.

Weaker state-controlled firms have been assisted in a number of other ways, directly and indirectly, including via the banking system, in the context of conditional debt-relief schemes.

Banks and enterprises

Even though the structure of the banking system is evolving rather slowly, most banks' health improved sharply in 1994-95, owing to tightened prudential rules and to successful portfolio restructuring, and as a consequence of the overall economic expansion. A number of sectors and regions, however, did not share in the general upturn, despite various forms of governmental aid.

The structure of the banking sector

The banking sector is still dominated by the state, which at the end of 1995 accounted for 54 per cent of total capital. There are four main groups of banks. The largest one comprises six formerly specialised state-owned banks, including a ''domestic'' savings bank (PKO BP), a savings bank for foreign currency deposits (PKO SA), a foreign trade bank (Bank Handlowy), and an agricultural bank (BGZ). The second group consists of nine banks carved out of the former central bank in 1989, four of which had been privatised by early 1996. The first two groups concentrate the bulk of loans and deposits (Table 10). The third group encompasses over 1 500 small co-operative banks, inherited from the socialist era. The last group is formed by the new private banks, of which 18 are foreign-owned. The total share of foreigners in the sector's capital amounted to 19 per cent at the end of 1995 (Dutch investors being in the lead with one third thereof). On the whole, Poland is distinctly underbanked and transactions are largely cash-based. Polls suggest that half of the population has no contacts with banks at all.[50]

Privatisation of the banking sector is to continue in 1996. As in the enterprise sector, much thought has been given to consolidation prior to ownership transfer, with a view to build ''national champions'' strong enough to compete

Table 10. **Market shares of main groups of banks**

Per cent, end-year

	1992	1993	1994	1995
Balance sheet total				
Formerly specialised banks	50.8	48.4	47.4	46.4
Nine banks [1]	30.3	31.0	32.1	31.9
Co-operative banks	6.8	6.5	5.2	4.8
Private banks	12.1	14.1	15.3	16.9
of which:				
Foreign-owned banks [2]	1.5	2.6	3.2	4.1
Lending				
Formerly specialised banks	43.9	44.3	41.9	38.8
Nine banks [1]	34.4	32.5	34.1	36.0
Co-operative banks	8.7	7.3	6.4	5.2
Private banks	13.0	15.9	17.6	20.0
of which:				
Foreign-owned banks [2]	0.9	2.3	3.6	5.1
Deposits				
Formerly specialised banks	53.2	54.0	53.8	54.0
Nine banks [1]	29.3	28.1	29.3	27.9
Co-operative banks	8.2	7.7	5.9	5.5
Private banks	9.3	10.2	11.0	12.6
of which:				
Foreign-owned banks [2]	1.4	2.1	2.7	3.0

1. Banks spun off from the former central bank.
2. Banks with more than 50 per cent of foreign capital.

Source: National Bank of Poland.

with large foreign entities once the latter enjoy freer access to the Polish market. A major initiative was announced in the autumn of 1995 involving the re-grouping of some of the remaining state-owned banks around two poles centred respectively on Bank Handlowy and PKO SA: Pomorski Bank Kredytowy (PBK-S) but also the already partly privatised Bank Przemyslowo-Handlowy (BPH) were to join the first holding; the second holding would have included Powszechny Bank Gospodarczy (PBG), Bank Depozytowo-Kredytowy (BDK) and Polski Bank Rozwoju (PBR). A large chunk of the shares of those new holdings would not be sold but used by the state as a contribution to the envisaged pension funds, and to compensate pensioners for incomplete indexation and those who could not participate in earlier privatisation operations on favourable terms.

The authorities argued that this formula would allow them to meet the end-1996 deadline conditioning the release of the monies in the Polish Bank Restructuring Fund (ex, unused, Zloty Stabilisation Fund), which would be used to service the re-capitalisation bonds with which the state endowed seven of the nine banks (see below). They added that the scheme would catalyse synergies in banking operations and cut overhead costs. Moreover, it had the merit of extinguishing part of the state debt without direct budgetary implications. Representatives of the banks concerned, including the private shareholders of BPH, reacted rather critically, complaining about a lack of prior consultation and worried by the fact that the mergers would precede privatisation, which in their view was likely to put off the latter and the ability to raise fresh, private capital.

The law on banking sector consolidation passed by the Sejm in April 1996 and signed by the President in July 1996 restricted the scope of the scheme to banks wholly owned by the state (or the central bank). On current plans, Bank Handlowy would be the first to be privatised, either in isolation or after incorporating PBR. A group formed in September 1996 around PKO SA and including BDK, PBG and PBK-S would follow in 1998. Besides, Powszechny Bank Kredytowy is to be privatised in late 1996-early 1997.

Bank health and performance

On several measures, the health and performance of most banks improved in 1994-95 (Table 11). The burden of non-performing loans fell sharply, as their share in the total portfolio of non-co-operative banks shrank from 31 to 21 per cent.[51] At the same time, further provisioning efforts brought the coverage of bad loans above regulatory standards. The profitability of the nine banks and of the formerly specialised banks increased.[52] Profitability declined on aggregate for foreign banks, but starting from a relatively high level and partly reflecting the take-over of some troubled Polish banks.[53] The number of banks with low or even negative solvency ratios broadly remained constant (six of those banks are in the process of being liquidated). At the same time, margins have tended to decline, reflecting heightened competitive pressures and the declining toll of bad loans. As inflation subsides, and with it some of the benefits accruing to financial intermediaries, banks are induced to innovate and to move up on the technological ladder. Anecdotal evidence points to an increasing sophistication in the modalities of competition, which involves more than quoted interest rates. On the

Table 11. **Indicators of banks' health and performance**

Excluding co-operative banks and liquidated BHK SA, end-year stocks

	1993	1994	1995	
Total number of banks	87	82[1]	85[2]	
Solvency				
Not at required level of 8 per cent	18	18	17	
of which:				
Negative solvency ratio	13	15	15	
Profitability				
Number of loss-making banks	24	20	14	
Gross profit / income				
Nine banks[3]	19.7	20.7	22.8	
Formerly specialised banks	–1.5	0.0	14.5	
Private banks	–2.5	–0.6	13.1	
of which:				
with majority Polish capital	–4.0	–8.2	9.8	
with majority foreign capital	32.3	27.9	21.2	
Non-performing loans (in per cent of total loan portfolio)				
Substandard[4]	7.1	5.7	5.0	
Doubtful[5]	6.0	5.3	3.4	
Lost[6]	17.9	17.7	12.8	
Total	31.0	28.7	21.2	
Loan provisioning (in per cent of loan portfolio according to categories)	<—— Actual ——>			Required
Sub-standard[4]	16.3	25.8	26.1	20
Doubtful[5]	25.0	55.4	59.5	50
Lost[6]	87.1	100.1	100.2	100
Total (in per cent of requirement)	82.6	103.1	103.8	
Memorandum item: Actual provisions in Zl billion	4.6	6.9	7.6	

1. Including 5 banks in liquidation or with activities suspended.
2. Including 6 banks in liquidation, suspended or in bankruptcy.
3. Banks spun off from the former central bank.
4. (a) Assets where principal or interest payments are delayed by one to three months.
   (b) Claims on debtors whose financial situation may jeopardise the timely payment of the asset.
5. (a) Assets where principal or interest payments are delayed by three to six months.
   (b) Claims on debtors whose financial situation has deteriorated substantially, particularly if the firm's equity capital has been eroded.
6. (a) Assets where principal or interest payments are delayed by more than six months.
   (b) Claims on debtors declared insolvent or put into liquidation, excluding liquidations in connection with privatisation.
   (c) Claims on debtors when the bank has petitioned for foreclosure or has commenced recovery of assets under other procedures.
   (d) Claims being contested by debtors in court.
   (e) Claims on debtors whose whereabouts are unknown.
   (f) Claims on debtors whose financial situation has deteriorated irretrievably.

Source: National Bank of Poland.

deposit side, greater attention is being paid to access to banks' branches, and generally more efforts are made to offer customers tailor-made services.

Notwithstanding visible progress, rigidities and handicaps remain in Polish banks. Staffing commonly continues to be qualitatively inadequate, and a number of instruments frequently used in advanced market economies are still in their infancy, available if at all only on an over-the-counter basis (*e.g.*, derivatives). Some of the old specialised establishments are in a particularly difficult situation. PKO BP, the Polish bank with the largest balance sheet, is burdened by a large chunk of non-performing housing loans inherited from pre-transition times.[54] The restructuring of BGZ is still far from completed, its capital/asset ratio standing at a dismal minus 43 per cent at the end of 1995, and the share of non-performing loans at 59 per cent. Ever since the early 1980s, poor loans have been a major problem. Over the past few years, the bank has already received several massive capital injections (Zl 0.4 billion in 1993, Zl 1.5 billion in 1994, and Zl 0.6 billion in 1996), but it is by no means certain that the latest one will be the last. Although BGZ's poor performance is clearly related to the difficulties experienced by the agricultural sector, it also reflects the consequences of politicised lending decisions. The situation of co-operative banks also remained difficult, and 65 of them were declared bankrupt in 1995 alone.[55] Discussions are under way on the reorganisation of the co-operative banking sector.

Dealing with bad loans

The fall in the share of bad loans in the aggregate balance sheet of the banking sector reflects the improvement in overall economic conditions and the increase in the volume of good new loans, including to small and medium-sized firms that are now able to approach banks with a track record under market conditions. It is estimated that only 2 to 4 per cent of the new credits turn bad, an encouraging result of the tightening of licensing requirements effected from 1992, in conformity with EU standards, and of the experience gained with supervision since.

The burden of bad loans also dropped as a result of the restructuring of the stock of delinquent credits inherited from the distant past or from the early 1990s, when borrowers were in dire straits and lending practices often sorely lacked prudence. A complex scheme was launched in 1993 in an attempt to deal once and for all with the stock of large bad loans. The March 1993 Law on Financial

Restructuring of Enterprises and Banks had a pre-determined three-year horizon and was not extended beyond March 1996, despite pressures to do so. The strict deadline was intended to oblige the parties involved to act swiftly. In contrast to the approach adopted in some other transition countries, the scheme was set up so as to allow portfolio restructuring to proceed in decentralised fashion, and based on economic criteria. It was also meant to force bankers to learn risk assessment and market techniques, and to foster a greater sense of commercial responsibility. Participating banks received restructuring bonds, conditional on the creation of bad loan work-out departments and the development and implementation of a restructuring programme.[56] They were also granted some tax incentives for write-offs.

The ten main banks involved (seven of the group of nine, PKO BP, PKO SA, and BGZ) were endowed with Zl 4 billion worth of recapitalisation bonds.[57] In co-ordination with other creditors, these banks initiated 565 conciliatory procedures, covering 32 per cent of the total stock of credits under consideration (Table 12). By end-March 1996, 460 of those, corresponding to 29 per cent of the stock, had been completed. These agreements involved some rescheduling and some concessions on principal or interest. This route was chosen for those enterprises deemed to offer relatively good prospects. Debt service also resumed on 13 per cent of the loans. Some 15 per cent of claims were sold on the

Table 12. **Results of the law on financial restructuring of enterprises and banks**[1]

	Value (million Zl)	Share	Number of credits	Share
Total debts in programme	4 703	100	2 916	100
Conciliatory agreements	1 498	32	565	19
of which: completed	1 352	29	460	16
Debt service resumed or debt repaid	602	13	485	17
Credits sold	682	15	545	19
of which: completed	317	7	259	9
Liquidation or bankruptcy	1 279	27	828	28
of which: completed	1 189	25	760	26
Debt-equity swaps	0	0	0	0
Decision pending	642	14	493	17

1. As of 31 March 1996, and for the portfolio of loans exceeding Zl 0.1 million as of December 1992 of the ten banks receiving restructuring bonds.
Source: Ministry of Finance.

secondary market, typically at a fraction of their face value. Other claims were dealt with in bankruptcy courts. The scheme was also intended to speed up privatisation, and included the option of debt-equity swaps. However, few such operations materialised, in part it seems for tax reasons (Van Wijnbergen, 1996). On the whole, the scheme seems to have been more successful than many of those tried out in neighbouring countries, although its ultimate success can only be gauged in the longer run. In some prominent cases, such as that of the Ursus tractor factory – which still has large social security arrears – it does not appear that the restructuring of the debt marked the dawn of truly hard budget constraints.

Sectors and regions

The first stage of transition saw a drastic cut in subsidies to producers and consumers and the emergence of a new set of relative prices. Faced with hard budget constraints and different demand patterns, firms had to and did adjust.[58] Some, however, clearly adjusted more than others, and by the mid-1990s, overmanning remained rife both in SOEs and in privatised firms. Arrears on tax and social security dues were another sign of maladjustment (Chapter I, Table 5).

The problems remain particularly severe in a number of heavy industrial sectors such as coal mining, steel, shipbuilding, and chemicals. Some branches indeed faced greater challenges than others at the onset of transition, as the distortions inherited from the former regime handicapped some and favoured others. However, even if such differences in initial conditions can explain divergent performance in the short run across sectors, they do not necessarily doom longer-run adjustment efforts to failure. The shipbuilding industry provides a striking example of how two enterprises starting with similarly penalising legacies evolved in opposite directions because they followed different strategies (Johnson and Loveman, 1995):

– The Szczecin shipyard resolutely engaged in deep restructuring. About 700 of the 6 000 jobs were eliminated early on. Debts were restructured in 1992 (under terms less lenient than those of the aforementioned 1993 law). Positive profits started to be generated in 1993. The enterprise was privatised in 1993, and transferred out most of its social assets (housing in particular). By 1995, it had become the sixth largest shipyard in the world, offering very short building times, employing 7 300 workers, and

exporting 100 per cent of its ships (primarily to Germany). In addition, productivity and wages far exceeded those elsewhere in the sector, and no strikes had occurred since the late 1980s.[59]

– In contrast, the Gdansk shipyard – the cradle of the Solidarity trade union in the early 1980s – declined a drastic restructuring proposal put forward by a foreign investor in 1989, pronouncing gradualism to be superior. The strategy adopted involved the maintenance of product lines, employment and wages, and a heavy reliance on state support, which until 1995 was facilitated by a privileged rapport with the President. This approach proved to be eventually self-defeating, and ended in bankruptcy in mid-1996.[60]

Another notoriously troubled sector is hard coal mining, which has undergone several restructuring programmes since the 1980s but is still in dire straits. Cumulatively, production shrank by 23 per cent between 1989 and 1995, and employment by 32 per cent (Table 13).[61] At the same time, the relative domestic price of coal was increased two-and-a-half-fold, and wages rose faster than in the rest of the economy. As a result, the labour cost per tonne in Poland at the end of 1995 amounted to $17, compared with $5-6 in the United States and Canada. Financial performance remained dismal, with recorded losses amounting to Zl 413 million in 1995. In March 1996, hard coal mines on aggregate owed Zl 8.3 billion to the state (back taxes and social security contributions), the banks and their suppliers, while their receivables only totalled Zl 3.4 billion.

Table 13. **Hard coal: performance indicators**

	1989	1990	1991	1992	1993	1994	1995
Number of mines	70	70	70	70	68	68	65
Output (million tonnes)	177.6	147.7	140.3	131.5	130.5	133.9	137.2
Employment (thousands)	415.7	387.9	352.9	336.4	319.6	291.9	281.1
Output per worker (tonnes)	427	381	398	391	408	459	488
Exports (million tonnes)	28.9	28.1	19.5	19.6	23.0	27.7	31.9
Relative domestic price (1989 = 100)[1]	100	117	189	188	212	259	249
Relative wage (1989 = 100)[2]	100	92	97	99	104	117	111
Unit cost (in $ per tonne)		19.48	29.63	32.57	31.23	33.64	38.60

1. Relative to the industrial producer price index.
2. Average wage for workers in the hard coal industry relative to the economy-wide average wage.

Source: Hard Coal State Agency, Central Statistical Office, International Energy Agency.

Coal mines had been given some autonomy in the early 1990s but were reconsolidated in 1993 into six joint-stock companies and one holding grouping 11 mines, despite vocal opposition from the Anti-Monopoly Office. Wages shot up in the mines thus benefiting anew from cross-subsidisation, and the liquidation of hopeless sites was either postponed or implemented too slowly. In March 1995, as domestic coal prices overtook import prices, price controls were re-introduced in the form of the obligation for coal companies to solicit prior administrative clearance for price increases. As domestic supply much exceeded a shrinking domestic demand, exports increased, reaching 32 million tonnes in 1995, or 23 per cent of output. With world prices on average Zl 30 per tonne lower than domestic prices, huge losses were incurred on those exports and imports rose to 1.5 million tonnes (and would have been much higher had it not been for large domestic transportation costs).

In April 1996, the economic committee of the government approved a new restructuring programme covering the second half of the 1990s. It involves massive new state subsidies. By 2000, some 80 000 of the 260 000 existing jobs would be eliminated. Of those, 52 000 would disappear through attrition (mostly old-age pensions), 12 000 through early retirement and 14 000 by shifting staff to companies to be set up on the basis of the assets of some mines. Some 2 000 miners are further expected to quit and take up preferential credits to start their own businesses. Eight mines would be closed, and others merged. Production would be cut cumulatively by some 20 million tonnes, or 15 per cent.

These targets imply that labour productivity would rise only by 4 per cent per annum. Even if implemented, efficiency by 2 000 would therefore remain low by international standards, and output per capita would reach only 615 tonnes, or less than a third of the current average in the United Kingdom for instance. In addition, the industry will need to find ways to dispose of the 140 000 apartments it owns, the maintenance of which is a heavy burden. Significant further environmental investments are also required. The hard coal sector is thus likely to remain a drain on the budget in the foreseeable future.

The production of hard coal is heavily concentrated in the Katowice region, the biggest old industrial area in Central Europe, from which 97 per cent of the national output of coal originates. The throes of this sector are therefore also an acute regional problem. More generally, sectoral and regional difficulties tend to overlap, due to inherited over-specialisation. The transformation is more painful

in the rural areas of the North (where many of the former state farms are located) and East, the areas with a high concentration of a few heavy industries (particularly in the defence sector), and the relatively remote areas lacking infrastructures. In this connection, regional polarisation is seen by some to have increased during the first half of the 1990s (Task Force for Regional Development in Poland, 1996), although the relevant regional statistics required to document this assessment are sparse.[62]

One of the measures taken to cope with these disparities has been the identification of distressed areas, which are granted a number of advantages. A list started to be maintained in 1991, chiefly based on the criterion of registered unemployment exceeding twice the national average. Ancillary criteria included the number of unemployed graduates, the scale of mass lay-offs, the number of unemployed ineligible for unemployment benefits and the degree to which the labour market is monopolised by a few employers. This list was extended several times. By 1994, it comprised 491 gminas spread over 27 voivodships and covering 18 per cent of the total population. These areas are granted extended unemployment benefit entitlement periods, extra resources for active labour market policies, and lower taxes or tax holidays for new investors. For instance, infrastructure development subsidies are made available in the form of public work programmes (Zl 55 million in 1995). Another example is the deductibility of up to 50 per cent (75 per cent in the smaller gminas) of investment outlays from taxable corporate income if the enterprise increases employment by a certain amount. The Ministry of Industry and Trade is furthermore considering the possibility of offering exemptions from social security contributions. Besides the list of distressed areas, there is an envelope of subsidies to support regional restructuring programmes (Zl 30 million in 1995) that can be disbursed at the discretion of the Council of Ministers.

More recently, a special economic zone (SEZ) programme was launched, drawing in particular on the experience of Ireland. A law to that effect was passed in October 1994, granting investors total income tax relief for ten years and 50 per cent relief for the following ten years provided, among others, that the investment is large enough (specific financial and job creation thresholds are decided by an ordinance of the Council of Ministers on a case by case basis). Other advantages offered include the exemption from the real estate tax and accelerated depreciation. SEZs can only be established when they are deemed

necessary for the restructuring of the area, and they are meant to attract modern technologies.

The first SEZ was set up one year later in the south-eastern town of Mielec. Few sizeable new investments had come in by mid-1996, however. To some extent, bureaucratic delays may have been to blame. More importantly perhaps, large potential investors may have the leverage to request the creation of a SEZ where it suits them best, as seems to be the case with the car factory envisaged by General Motors in Gliwice (Katowice voivodship). As many as seven other sites for new SEZs are under consideration for 1996-97 (including in or near Suwalki, Czestochowa, Lodz, Walbrzych and Gdansk). Dozens of applications from voivodship governors proposing to set up a SEZ have already reached the central authorities.

A related formula has lately been proposed by the Ministry of Industry and Trade, dubbed ‘‘project concentration areas’’. Those would be set up on land vacated by former state farms and in mono-industrial municipalities, and would offer advantages analogous to those associated with SEZs but less generous.

No thorough analysis of the effectiveness of these positive discrimination measures has been conducted to date (Task Force for Regional Development in Poland, 1996). However, some of the costs and risks associated with such policies can be noted. Granting tax exemptions or straight subsidies burdens public finances in the short run. Local incentives are geared towards extracting maximum support from the centre and the competition between regions in this politicised process is likely to result more in diversion of investment and job creation from one locality to another than in net overall gains. Another danger stems from the fact that it may be difficult to de-classify distressed areas. Indeed, the first review of the list, in mid-1996, saw the introduction of what could be described as an ‘‘outdated economic base’’ criterion alongside that of high unemployment, enabling several gminas where unemployment had dropped to remain on the list. Nevertheless, consistent with the general improvement in economic performance, the review resulted in a substantial shortening of the list, as 100 gminas were deleted and only 14 added.

III. Coping with human costs in the transition and beyond

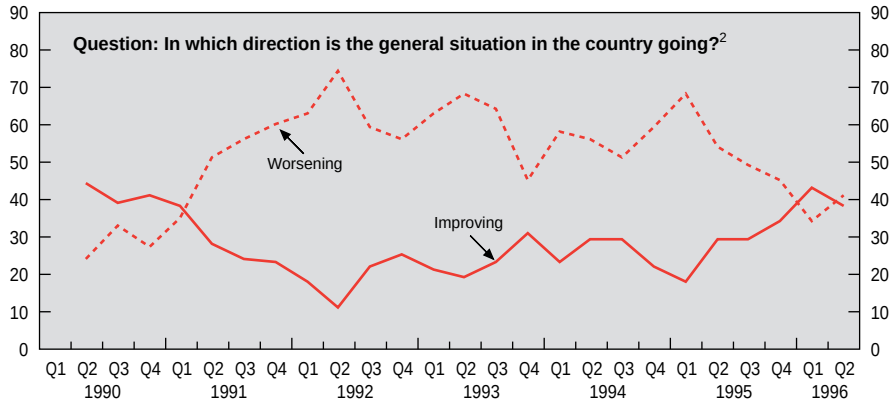
Half a decade into transition, and after four years of rapid growth, any assessment of welfare developments is likely to sound somewhat ambivalent.[63] Household surveys suggest that, overall, perceptions of well-being are improving, albeit slowly (Figure 21). Perceptions appear to be closely correlated with economic fundamentals.[64]

This chapter focuses on selected dimensions of household welfare. Measured inequality increased during the first half of the 1990s. More worryingly, poverty indicators also deteriorated. Unemployment is one of the main causes of poverty, and is likely to remain high for some time, which underlines the necessity of an appropriately targeted and financially sustainable social safety net. Demographic trends are putting pressure not only on the labour market but also on the pension system, which is in urgent need of far-reaching reform.

Inequalities and poverty

Inequality and poverty are obviously interrelated, and no less obviously distinct. Rising inequality may be the sign that skills are being rewarded more efficiently. In contrast, growing poverty stemming from falling average incomes and increasing inequality is socially disruptive. Definitional and measurement problems, however, make it difficult to come up with more than a nuanced qualitative characterisation of the evolution of inequality and poverty since the late 1980s.

Figure 21. **PERCEPTIONS OF TRANSITION**[1]
In per cent of respondents



1. Mid-quarter observations, except for the third quarter (for which July is used, owing to missing observations for August). Representative sample of 1 000-1 200 persons.
2. Respondents had to choose between "Improving", "Worsening" and "Difficult to say".

Source: Centre of Research of Public Opinion (CBOS).

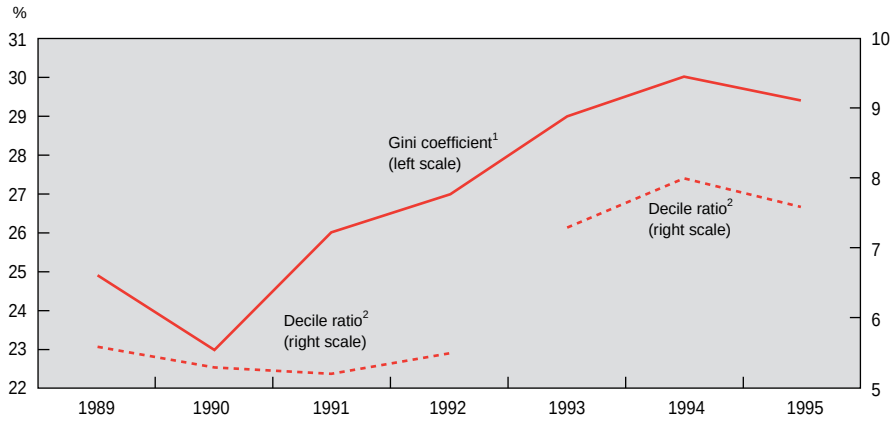
Real incomes and inequalities

Official statistics of nominal household money incomes deflated by consumer prices show rapid growth in 1988 and 1989, by a cumulative 20 per cent or so, followed by a collapse in 1990, by almost 30 per cent. After several years of near stagnation, this indicator started to pick up in 1994 and in 1995 stood at around 90 per cent of its 1987 base level.[65] This measure, however, is potentially misleading. The late 1980s witnessed lengthening queues and near-hyperinflation. With price liberalisation, shortages virtually ended, as did queuing and forced substitution. And with stabilisation, the burden of the inflation tax dropped. Average consumer utility therefore evolved very differently from recorded real incomes, also because the excess wage tax and other taxes encouraged systematic under-reporting of earnings in the early 1990s. An additional source of distortion of the real income measure (working in the opposite direction) is the gradual commercialisation of heretofore largely public goods and services (such as housing, health care, child care, education and recreation), which in all likelihood is imperfectly captured in nominal income measures and

in the deflator. Moreover, what really happened to aggregate welfare cannot be assessed without a judgement on how to average what happened to individual real incomes. Since the latter are not perfectly correlated, the averaging method will influence the results.[66]

Measured income inequality increased sharply between the late 1980s and the mid-1990s, as it did in virtually all transition economies (Milanovic, 1996), but the most recent data suggest that it may have peaked in Poland around 1994 (Figure 22). The bulk of the increase took place as aggregate output was growing anew, but the experience in neighbouring countries suggests that it would have occurred irrespective of output performance. The Gini coefficient rose from about 25 per cent in 1989 (the first year for which it is available) to about 30 per cent in 1994, which is close to the OECD average but remains well below the levels typically encountered in middle-income countries (World Bank, 1996). It declined slightly in 1995, to 29.4 per cent. Likewise, the decile ratio rose from 4.9 in 1987 to 8.0 in 1994, but receded to 7.6 in 1995. The quintile ratio

Figure 22. **INCOME INEQUALITY**



1. Summary inequality statistic, defined as the area between the observed Lorenz curve (cumulative income distribution) and the line of absolute equality. Varies between 0 (absolute equality) and 100 per cent (maximum inequality).
2. Average income of the 10 per cent top recipients over average income of the bottom 10 per cent. Farmer households excluded from 1993.

Source: Central Statistical Office.

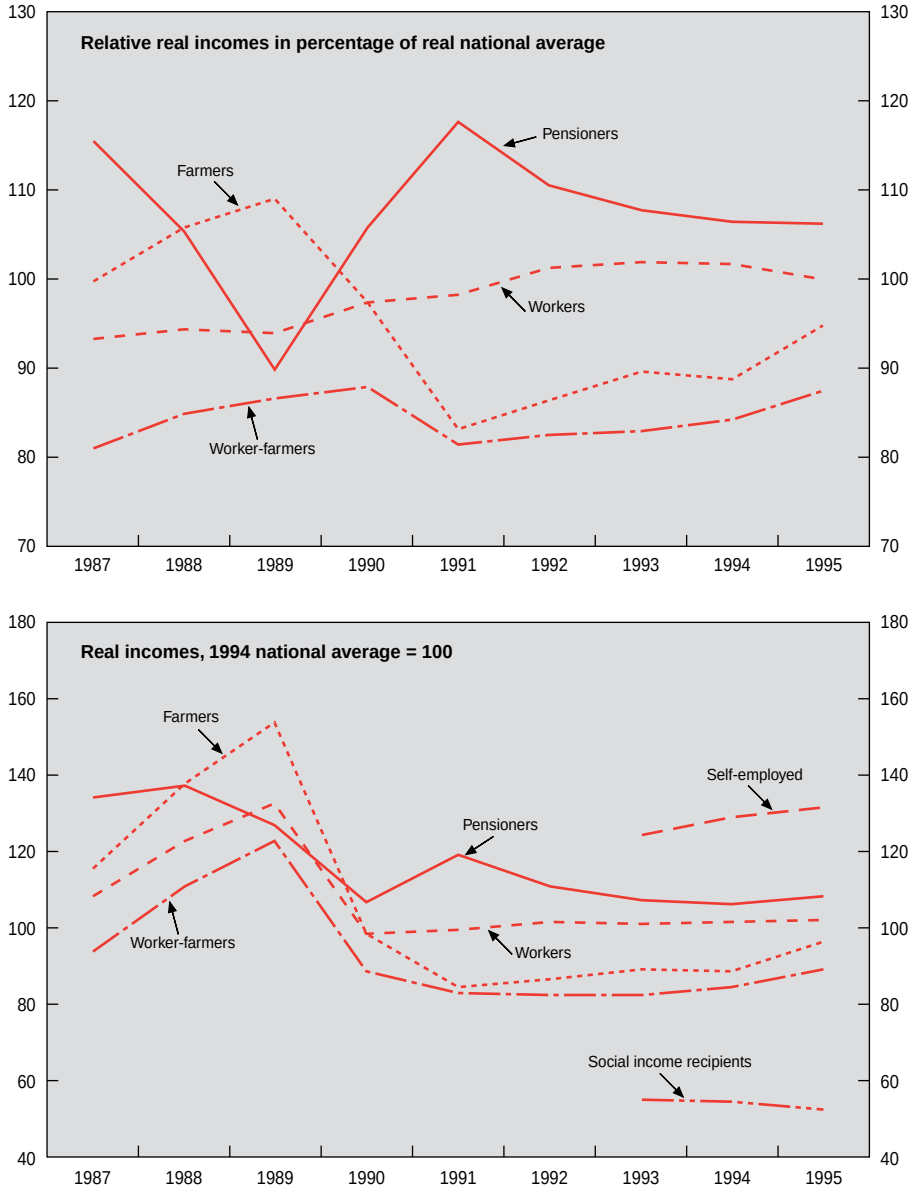
behaved analogously, rising from 3.5 in 1987 to 4.9 in 1994, and edging down to 4.8 in 1995.[67]

One aspect of income differentiation is the divergent evolution of the relative incomes of the main socio-economic categories, which can be traced since 1987 for the four groups traditionally distinguished in household budget surveys (workers, farmers, worker-farmers and pensioners), but can only be quantified from 1993 for the two groups added in that year, namely the self-employed and the social income recipients. Between 1987 and 1995, workers and worker-farmers enjoyed an improvement in their relative position, whereas farmers and pensioners saw a deterioration (Figure 23, top panel). But both the gains and the losses were limited in scope, amounting to less than 10 per cent. The use of different base years would produce strikingly different results: for example, pensioners recorded a 15 per cent rise in their relative income between 1989 and 1995. The newly distinguished group of the self-employed includes business owners and independent professionals outside agriculture, who have the highest incomes, at 30 per cent above average in 1995 (Figure 23, bottom panel). Social income recipients are defined as mainly dependent on non-earned income and are at the bottom of the scale, with average incomes equal to only half the average in 1995.

Within all four groups for which disaggregated data are available – workers, self-employed, pensioners and social income recipients – inequality as measured by the quintile ratio rose from 1992-93 to 1994 and declined somewhat in 1995, respectively to 4.4, 5.8, 4.0 and 4.7.

Another remarkable feature of the realignment of relative incomes and rising inequality has been the increase in returns to education. Whereas relative wages of workers trained in vocational schools generally dropped, those of university graduates generally increased, inverting the former wage hierarchy. The ratio of the median white-collar to the median blue-collar wage in industry rose from 0.98 in 1987 to 1.17 in 1993 (Rutkowski, 1996). Moreover, while the distribution of wages among white-collar workers was very similar to that among blue-collar workers in the late 1980s, the former had stretched out considerably by 1994, whereas the latter had not. Pay differentiation among the highly educated white collar workers has thus become more pronounced. It is also more conspicuous in the private than in the public sector. Partly as a result of rising skill premia, and notwithstanding the increase in effective tuition costs, higher

Figure 23. **LONG-RUN EVOLUTION OF REAL INCOMES**



Source: Central Statistical Office.

education enrolment rates soared in the early 1990s, reaching 26 per cent of the 19-24 year age group in 1995-96 (*i.e.*, about the OECD average).

At the same time as income differentiation as captured by aggregate Gini or decile ratios came to a halt, a distinct improvement in the perception of their material well-being was noticeable in all six socio-economic groups in 1994-95 (Figure 24). Concurrently, saving rates rose in all groups. These are signs that the benefits of growth may have started to ''trickle down''.

Poverty

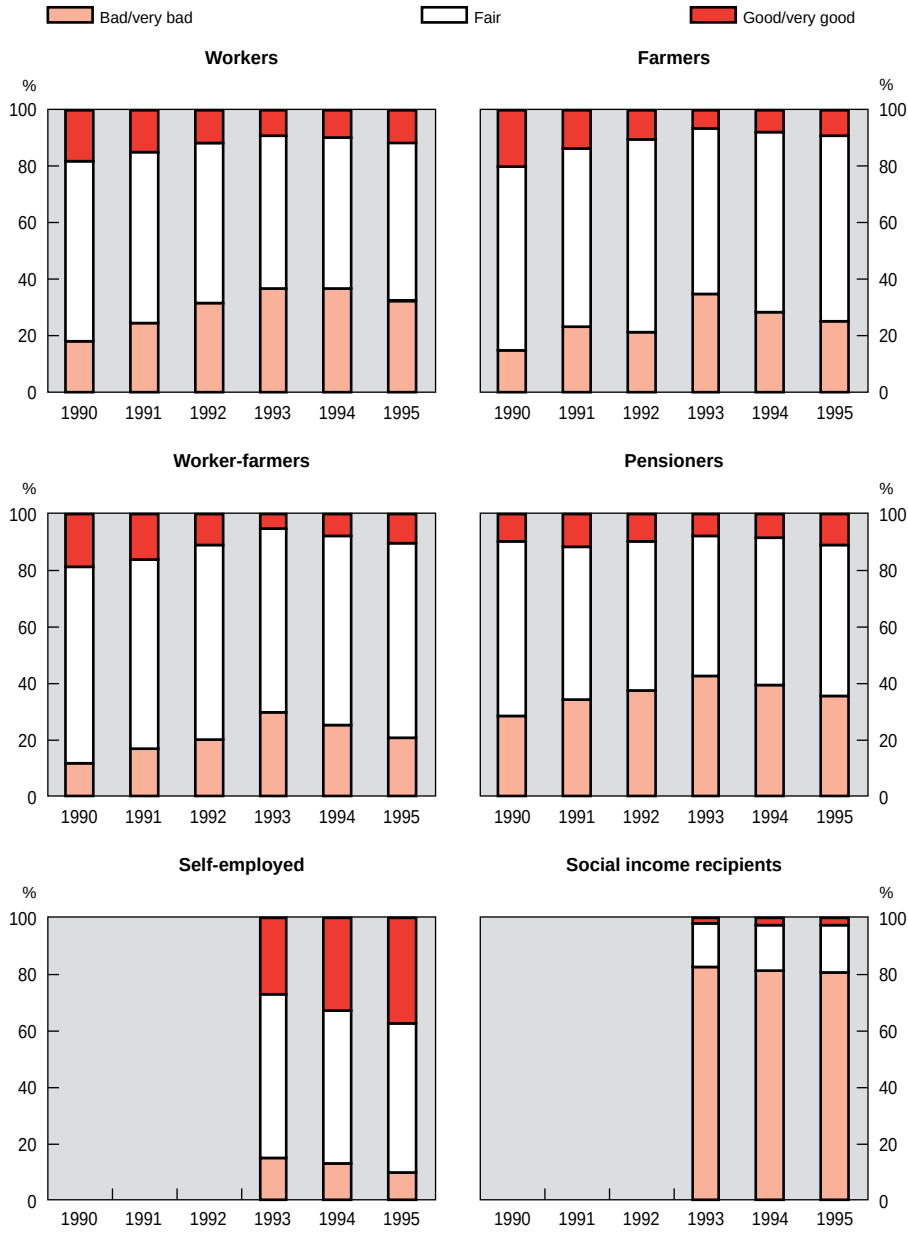
Despite the abundance and variety of poverty measures and the ensuing scope for confusion, they tend to point to a similar diagnosis: poverty increased in the early 1990s but may recently have peaked.[68]

Poverty is commonly measured as the number of people living below a certain standard (headcount) or as the cumulative income shortfall of those who live below this standard (gap). The standard itself, called the poverty line, can be defined in income or expenditure terms. It is sometimes defined as a percentage of the national average (relative concept), or as a bundle of goods and services (absolute concept). It may describe a physiological minimum (needed for survival) or, more generously, some socially acceptable minimal standard of living. It may be calculated from household budget data or it may be derived from surveyed households' intuitive perceptions.

As apparent from Table 14, which shows various measures of the poverty headcount, widely disparate estimates are associated with those different concepts. The most restrictive ones indicate that less than one tenth of the population lived in poverty around 1994, whereas according to the most generous ones half of the population lived below the poverty line. The latter estimates clearly exaggerate the extent of poverty, since they reflect a ''comfort level'' that households themselves consider to exceed the poverty threshold: indeed, the subjective poverty measure suggests that in 1995 less than one third of households viewed themselves as poor.

Assessing the evolution of poverty over time is complicated by the lack of consistently monitored series and, when such series do exist, by the same factors as those affecting the interpretation of the long-run real income series. From the fragmentary evidence that is available, and with the requisite caveats, it neverthe-

Figure 24. **SUBJECTIVE EVALUATION BY HOUSEHOLDS OF THEIR MATERIAL WELL-BEING**



Source: Central Statistical Office.

Table 14. **Alternative measures of poverty**

Percentage of the population below the line

	1990	1991	1992	1993	1994	1995
Expenditure-based measures of relative poverty						
50 per cent of average equivalent expenditure of households (GUS)	. .	. .	. .	12	14	13
60 per cent of average equivalent expenditure of households (GUS)	. .	. .	. .	23	24	23
50 per cent of mean equivalent expenditure of households (Szulc, 1995)	12	8	8	12	. .	. .
Income-based measures of absolute poverty						
Minimum sustainable level of income per household (Institute of Labour and Social Studies)	34	32	40	46	49	49
Social minimum per capita (Warsaw School of Economics)	37	36	45	51	52	53
Minimum retirement pension (GUS)	. .	. .	. .	16	19	. .
Subsistence minimum (GUS)	. .	. .	. .	. .	6	. .
PPP$ 120 per month at 1990 prices (Milanovic, 1996)	. .	. .	. .	19	. .	. .
Subjective poverty measure (income based)						
Leyden poverty line (GUS)[1]	. .	. .	. .	40	33	31

1. Fourth quarter observations.
Source: As noted.

less appears that poverty was significant in the 1980s and did increase in the early 1990s. Based on the (overly generous) poverty line monitored by the Institute of Labour and Social Studies, the proportion of the poor roughly doubled between the late 1970s and the late 1980s (Milanovic, 1992), and roughly doubled again between the late 1980s and 1992. The order of magnitude of the second of those increases is not inconsistent with estimates based on incomes valued at purchasing power parity exchange rates (Milanovic, 1996), although the poverty level implied by the latter measure is less than half as high.

Turning to recent poverty developments, several measures show a marginal decline in 1995. However, two of those correspond to relative poverty concepts and as such their decrease reflects falling inequality. Such measures are not directly affected by changes in overall living standards and would therefore not properly show how growth may over time lift large numbers of people out of (absolute) poverty. The fact that the subjective poverty indicator dropped sharply

in 1994-95 nonetheless suggests that the dividends of growth are being shared by the poorer segments of society, pulling some of the poor out of poverty.

One of the relative poverty measures is used by the Central Statistical Office (GUS) to conduct in-depth poverty analyses (Ochocki and Szukielojc-Bienkunska, 1996). This measure is based on expenditure rather than income data, which are felt to suffer more from under-reporting biases. Those households or individuals are considered poor who spend less than half of the national average, taking into account family size. On this measure, the poor constituted 13 per cent of the population in 1995, but the incidence of poverty varied a lot across groups (Table 15). Most vulnerable were social income recipients, large families, rural residents, and persons with little schooling (these groups also stand out in other transition countries). Poverty incidence among the elderly was below average. A similar assessment emerged from an earlier radiography of poverty using the minimum pension as the (absolute) threshold and based on 1993 data (World Bank, 1995).

Poverty in Poland is relatively shallow. A large number of households live close to the relative poverty line (which is one of the reasons for the wide discrepancies between alternative poverty headcounts). The poverty gap is therefore not very large, amounting to 18 per cent of the poverty line in 1994-95. This is consistent with the fact that half of the poor individuals were newly poor in 1994: a high turnover rate of the pool of the poor means that poverty is for most a transient state, and that it is less likely to become entrenched.[69] Extreme and lasting deprivation nonetheless exists, including in the form of homelessness, which according to the non-governmental organisation Escape from Homelessness afflicts 250 000 to 300 000 persons.[70]

An alternative way to examine the depth of poverty is to focus on indicators of living standards of the poor, particularly of the long-term poor. Housing conditions, ownership of durables and consumption patterns suggest that a large portion of the poor do not live in extreme poverty (Table 16). This observation is also consistent with data on the possession of selected durables by social income recipients, indicating that in 1995 18 per cent of them owned a private car, 18 per cent a telephone, 94 per cent a refrigerator and 40 per cent a video-cassette recorder.

Poverty is frequently associated with unemployment. In 1995, poverty incidence in households with at least one unemployed was 25 per cent compared

Table 15. **Incidence of relative poverty**

In per cent

	Total poverty			Long-term poverty		
	1994		1995	One year or more 1994		2 years or more 1995
	Households	Persons	Persons	Households	Persons	Persons
Households total	10.1	13.5	12.8	4.9	7.1	5.1
By socio-economic group						
Workers	8.5	11.4	10.3			
Worker-farmers	12.4	14.8	16.9			
Farmers	15.6	18.6	17.3			
Self-employed	3.8	4.8	5.9			
Pensioners and retired	8.2	12.1	11.1			
Social income recipients	38.6	46.1	43.1			
By number of persons in household						
1-person	4.8	4.8	4.1	1.6	1.6	0.8
2-person	4.7	4.7	4.7	1.7	1.7	1.1
3-person	6.7	6.7	6.4	3.1	3.1	1.7
4-person	10.5	10.5	9.6	4.7	4.7	3.3
5-person	18.4	18.4	17.0	9.6	9.6	6.5
6-person and more	30.3	31.5	30.5	16.9	18.0	13.8
By family structure						
Married couples:						
without dependent children	3.7	3.7	3.6	1.2	1.2	0.8
with 1 dependent child	5.2	5.2	4.9	2.4	2.4	1.1
with 2 dependent children	9.4	9.4	9.0	4.6	4.6	3.1
with 3 dependent children	18.9	18.9	17.6	9.7	9.7	6.3
with 4 and more dependent children	37.9	38.8	37.2	22.8	23.6	17.2
Mother or father with dependent children	10.2	12.8	13.6	5.2	6.5	4.2
By locality size						
Towns:						
Total	7.3	9.8	8.6	3.4	4.9	3.4
200 000 and more inhabitants	4.9	6.6	5.4			
100 000-200 000 inhabitants	6.2	7.9	7.3			
20 000-100 000 inhabitants	8.4	10.9	9.8			
20 000 and less inhabitants	10.7	14.0	12.6			
Villages	15.7	19.7	19.2	7.7	10.2	7.3
By age of the head of the household						
34 years and below	13.0	19.3	15.6	7.0	8.7	6.5
35-44 years	12.5	14.9	14.6	6.5	8.5	6.3
45-54 years	9.1	11.8	11.3	4.1	6.0	4.3
55-64 years	6.6	10.3	8.7	3.0	4.3	2.7
65 years and over	7.3	11.8	8.8	2.7	3.8	2.8
By education level of the head of the household						
Higher	0.6	0.8	0.9	0.1	0.1	0.0
Secondary	4.9	6.8	6.0	1.9	2.7	2.1
Vocational	12.9	16.2	15.3	6.3	8.2	5.8
Elementary complete and incomplete	14.9	20.8	20.1	7.5	11.8	8.4

Source: Central Statistical Office.

Table 16. **Standards of living of the long-term poor**[1]

	Poor	*Memorandum items:* non-poor[2]
Housing conditions (in per cent of total number of dwellings except for the first line)		
Average number of persons per room	2.1	1.2
Running water	79.5	93.6
Hot water	41.5	74.6
Toilet	58.7	85.4
Central heating	32.9	68.7
Telephone	6.9	36.6
Possession of durables goods (in per cent of households)		
TV-set	97.2	98.7
of which: color TV-set	63.1	85.2
Washing machine	96.5	98.6
of which: automatic washing machine	25.1	62.8
Refrigerator	94.3	97.4
Freezer	20.1	36.6
Car	16.1	42.3
Consumption of selected food products (monthly, in kg per equivalent unit)[3]		
Bread	10.45	10.05
Potatoes	10.70	11.76
Fruits and vegetables	2.16	5.27
Meat	2.35	4.01
Butter	0.31	0.51
Milk and beverages (in litres)	8.42	9.99
Eggs (in pieces)	13.30	20.62
Structure of expenditures (in per cent)		
Food	62.3	39.3
Rent and utilities	12.8	16.5
Culture and recreation	2.3	5.4

1. Defined as households living below the relative poverty line in both 1993 and 1994.
2. Defined as households living above the relative poverty line in both 1993 and 1994.
3. Weights in household: first adult member: 1.0; other adults: 0.7; every child: 0.5.

Source: Central Statistical Office.

with 10 per cent in households with no unemployed member. Poverty incidence was higher still when unemployment had lasted more than one year.

Unemployment

The unemployment rate in Poland is still high compared with other European countries,[71] even after several years of faster output growth. And

although it has been declining since mid-1994, the rate of unemployment will in all likelihood remain in double digits for several more years. The associated costs – not least to the budget and to the unemployed themselves – warrant a closer look at the evolution and nature of unemployment. This section first describes the composition of the pool of unemployed, then turns to the underlying flows into and out of the pool, and ends with a characterisation of regional disparities, which to some extent overlap with sectoral ones.

The physionomy of unemployment

At the end of 1995, 13 (LFS) to 15 per cent (registrations) of the labour force was unemployed, which well exceeds the average in the other European OECD countries. Among the latter, only Spain (23 per cent) and Finland (17 per cent) had higher unemployment rates. Among the Visegrad countries, only Slovakia has recorded similarly high unemployment. Although mass joblessness is relatively recent in Poland, the structure of unemployment, shown in Table 17, in many ways resembles that observed in other OECD countries. The share of long-term unemployment is not very different from the OECD Europe average. The positive spread between female and male unemployment rates is also very similar. The incidence of unemployment among the young is comparable to that in other high-unemployment OECD countries. The same broad negative correlation between educational attainment and vulnerability to unemployment as in the rest of the OECD is observed. A notable difference is the relatively low rate of unemployment in the 45-year-and-older group in Poland, reflecting massive recourse to early retirement.

The single largest age group among the unemployed are the young (under 25), who make up one third of the total. The single largest group by educational attainment are those with basic vocational training, who constitute close to 40 per cent of the total. Crossing those two criteria, it appears that for the young leaving school the probability of finding a job is highly dependent on their education. In 1994, only 19 per cent of primary school graduates and 31 per cent of basic vocational school graduates were able to find work within one year; in contrast, 78 per cent of university graduates did.[72]

As to the proximate causes of unemployment, in 1995, still more than half of the unemployed had been laid off, and less than 10 per cent had voluntarily left their job.[73] Those lay-offs, however, mainly took place before 1995, as only a

Table 17. **Physionomy of unemployment**

In per cent, end-year

	1992	1993	1994	1995
Registered unemployment rate	13.6	16.4	16.0	14.9
Labour force survey unemployment rate	13.7	14.9	13.9	13.1
Incidence of unemployment (LFS)				
By gender				
Men	12.4	13.6	12.3	12.1
Women	15.2	16.5	15.7	14.4
By age				
Youth (15-24 years old)	29.0	31.6	31.7	30.9
Over 45 years old	7.8	8.5	7.4	7.1
By educational attainment				
University	5.3	5.0	3.6	3.0
Post- and vocational secondary	12.9	13.6	12.0	11.3
General secondary	16.5	16.2	16.2	15.3
Basic vocational	16.9	18.4	17.8	16.4
Primary	12.7	15.0	14.0	14.4
By residence				
Urban	15.8	16.9	14.8	13.7
Rural	10.3	12.0	12.4	12.2
Structure of unemployment				
By duration				
Share of long-term unemployed (over one year)				
Registered	45.2	44.8	44.2	37.4
LFS	39.6	35.8	41.6	39.9
Share of very long-term unemployed (over 2 years)				
Registered		19.9[1]	20.0	17.7
LFS	12.9	13.4	18.9	19.2
By proximate cause (LFS)				
Lay-offs	56.1	53.5	55.0	53.2
Quits	6.8	5.6	7.0	8.6
Re-entries into the labour market	19.8	19.3	17.0	15.9
New entries into the labour market	16.8	19.7	21.0	22.3

1. March 1994.

Source: Central Statistical Office.

small fraction of those becoming unemployed in the course of 1995 had been dismissed. The share of new entrants grew significantly, from less than 17 per cent in 1992 to over 22 per cent in 1995, partly reflecting growing cohorts of young adults.

Inflows and outflows

Although the rate of registered unemployment was not widely different in 1995 from what it had been in 1992, the magnitude of the underlying inflows and outflows increased significantly. The monthly rate of inflows – defined as the

average inflow into unemployment over the source population (*i.e.*, the working-age population excluding the unemployed) – rose from 0.7 per cent in 1992 to 1.0 per cent in 1995. In 1995, it thus stood well above the 0.3 to 0.6 per cent range observed in the more atrophied west European labour markets, but still well below the levels of around 2 per cent observed in the most fluid OECD labour markets (OECD, 1995*e*). The monthly rate of outflows – defined as the average outflow from unemployment over the number of unemployed – doubled from 4 per cent in 1992 to 8 per cent in 1995. This compares with outflow rates of around 3 per cent in Spain and France, and of close to 30 per cent in Canada and close to 40 per cent in the United States (in 1994).[74]

The intensification of flows is a welcome sign in so far as it mitigates the formation and deterioration of a stagnant pool of jobless people, a threat common to most transforming countries and not unknown in the more sclerotic OECD labour markets (Boeri, 1994). Further inflows will be sustained by arrivals of sizeable contingents of youth, and outflows by job creation, at least to the extent that labour market transitions go through unemployment. So far, as noted in Chapter I, direct job-to-job transitions have been frequent. So have direct transitions from employment out of the labour force and *vice versa*. As concerns registered unemployment, those direct transitions partly reflected inefficient intermediation by under-staffed and under-experienced labour offices (which are not tracking vacancies actively enough), and possibly also the stigma associated with the avowed status of unemployed, in a context where employers have relatively little information on the abilities of potential recruits.

Entrenched regional disparities

Consistent with the regional disparities described in Chapter II, unemployment rates vary a lot from one voivodship to the next, and even within voivodships (Table 18).[75] At the end of 1995, regional unemployment rates ranged between 5.3 per cent (Warsaw voivodship) and 28.6 per cent (Slupsk voivodship), and local unemployment rates between 3.4 per cent (Katowice) and 41.1 per cent (Goldap, in Suwalki voivodship). Regional dispersion as measured by the ratio of the extremes was thus higher than in France or Spain, but lower than in Italy. Both the max/min ratio and the coefficient of variation were strikingly similar to those observed in Slovakia at the end of 1995 (OECD,

Table 18. **Regional unemployment dispersion**[1]

In per cent, end-year

	1991	1992	1993	1994	1995
By voivodship					
Coefficient of variation	31.4	32.4	34.3	33.4	32.8
Maximum	18.6	26.6	30.3	29.8	28.4
Minimum	4.2	6.4	7.6	6.5	5.4
Maximum/Minimum	4.4	4.2	4.0	4.6	5.3
Decile ratio[2]	3.0	3.0	3.2	3.1	3.2
By locality					
Coefficient of variation		36.6	37.6	35.9	37.3
Maximum		34.2	44.3	41.8	42.4
Minimum		4.3	4.6	4.6	3.3
Maximum/Minimum		8.0	9.6	9.1	12.8
Decile ratio[2]		3.9	4.0	3.8	4.0
Memorandum item:					
National average	11.4	13.6	16.4	16.0	14.9

1. Registered unemployment.
2. Ratio of the unemployment rate in the top decile to that in the bottom decile.

Source: Central Statistical Office.

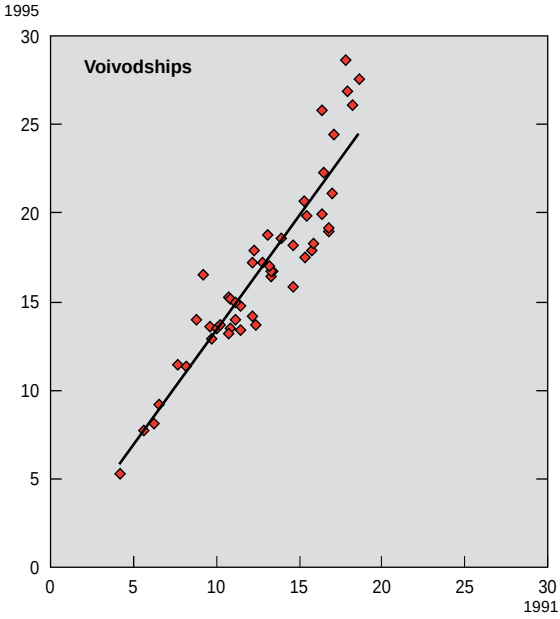
1996*d*). Within voivodships, unemployment was often much lower in the main city than in the surrounding rural areas (3.8 versus 10.9 per cent in the Warsaw voivodship, 6.5 versus 21.3 per cent in the Szczecin voivodship).

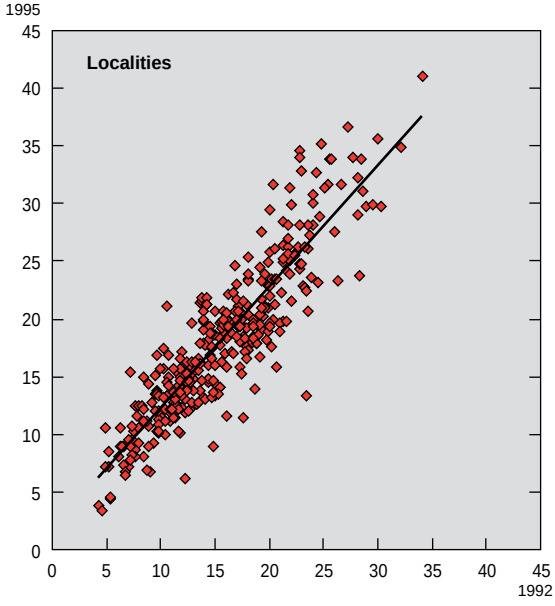
The degree of geographical dispersion of unemployment rates has remained virtually unchanged since 1991-92, notwithstanding rapid aggregate growth. Even more remarkably, the ranking of regions and localities has been extremely stable (Figure 25).

Regional differentials are rooted in profound structural differences, and the related uneven speed of transformation. Unemployment rates are higher-than-average in sparsely industrialised agricultural areas, which used to be dominated by now liquidated large state-owned farms (*e.g.*, the Slupsk, Suwalki, Olsztyn and Koszalin voivodships in the North), in areas burdened by declining industries (*e.g.*, Lodz in the Centre and Walbrzych in the South-West), and in localities dependent on one single large industrial employer (*e.g.*, Mielec, Stalowa Wola and Starachowice). Unemployment rates are also negatively correlated with the size of local labour markets (Figure 26): small localities tend to have less diversified economic structures, making job creation more difficult.

Figure 25. **REGIONAL UNEMPLOYMENT RATES**

In per cent, end-year





Source: Central Statistical Office.

Figure 26. **UNEMPLOYMENT RATE AND SIZE OF THE LOCAL LABOUR MARKET**
End-1995



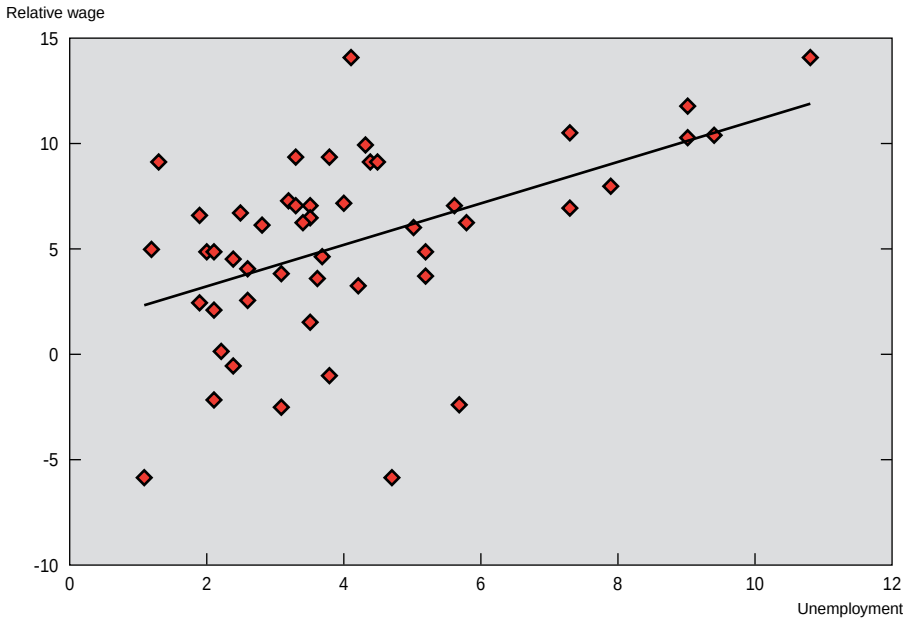
Source: Central Statistical Office.

Correspondingly, large numbers of unemployed are registered in regions with relatively low unemployment rates, and *vice versa*. For instance, Katowice voivodship has the largest concentration of unemployed in the country (151 000 persons end-1995) but the unemployment rate is well below the national average (9.2 versus 14.9 per cent end-1995).

Regional differentials also persist due to labour market rigidities. Housing is a key constraint in this respect. The stock, at 290 dwellings per 1 000 inhabitants, is small, even compared with the other Visegrad countries (and on sanitary or safety grounds about one tenth of it would have to be scrapped). Disincentives to move include the heavy subsidisation of communal rents, which attaches tenants to their dwelling and contributes to the thinness of the rental market. As concerns the buying market, laws were passed in 1995 allowing for the creation of housing

savings and loans institutions whose members will be eligible for tax deductible saving and low-interest loans, and for banks to offer pass-books with similar advantages. This concept is ultimately aimed at 20 to 30 per cent of households but it is unlikely to have a significant impact on the number of new mortgages in the near future. Given the size of the country and the poor communication infrastructures, long-distance commuting cannot reduce labour market segmentation substantially and prevent mismatches between local supply and demand of specific skills, which account for a sizeable proportion of overall unemployment (Coricelli *et al.*, 1995).[76] Wage rigidities may also play a role, as suggested by the fact that between end-1991 and end-1995 unemployment rose most in those voivodships where relative wages increased most (Figure 27). The correlation is not very strong, however, as many other factors are at play.

Figure 27. **WAGE STICKINESS AND UNEMPLOYMENT**
Per cent changes between 1991 and 1995 across voivodships



Source: Central Statistical Office.

Social safety net

The social safety net in place in the late 1980s was extensive but inefficient and ill-suited to the requirements of a market economy. Major changes were therefore introduced early on in the transition, sometimes without due consideration for their longer-run implications. Amendments to the new rules were subsequently introduced, but much remains to be done, especially regarding the pension system.

Social protection pillars

On many counts, the social benefits provided in Poland are quite generous by middle-income country standards. Table 19 lists some of the main cash benefits. In a broader perspective, one could add price subsidies (although by mid-1996 their importance had shrunk greatly) and public goods and services.

A number of measures have already been taken over the past few years to contain social expenditure growth. Even so, the expenditures of the main social funds represent 19-20 per cent of GDP (Table 20), which is more than in most middle-income countries. Demographic pressures make further reforms indispensable, in particular as regards unemployment compensation and pensions.

Unemployment insurance was introduced in 1989, with very generous provisions: benefits amounted to 70 per cent of the unemployed's last earnings during the first three months, 50 per cent from the fourth to the ninth month, and 40 per cent thereafter and indefinitely. The surge in registered unemployment soon led to a series of amendments tightening eligibility rules, restricting the duration to 12 months, cutting the size of the allowance, and de-linking it from past earnings. Until early 1996, the allowance was set at a flat 36 per cent of the average wage in the previous quarter. An important change took place in March 1996, when the link with the average wage was severed and the allowance was indexed, quarterly, on the CPI. Another notable change in early 1996 pertained to school-leavers: they no longer receive unemployment benefits but a stipend, which is typically smaller and conditioned on enrolment in one of various active labour market policy (ALP) schemes. In July 1996, some 1.3 million individuals were receiving unemployment benefits.

ALP schemes aimed at the unemployed include training, public works, ''intervention works'' (employment subsidies), start-up loans for the unemployed

Table 19. **Selected social benefits**

As of July 1996

Benefit	Level	Duration	Main eligibility criteria
Unemployment benefit	Zl 291 per month[1] Indexed to CPI quarterly	12 months[1]	Minimum 6 months of work during the last 12 months; income below half of the minimum wage; no more than one job offer refusal
Stipend for school-leavers	Linked to unemployment benefit (amount depends on case)	Up to 12 months	Enrollment in ALP scheme
Family allowance	Flat rate Zl 25 per month per child Indexed annually on CPI	Until child reaches 16 years (or 20 years if at school)	Income per family member below 50 per cent of average wage
Maternity allowance	Depends on previous wage	16-26 weeks	Working mothers
Child-care allowance	Flat rate Zl 180 per month (Zl 286 per month for single mothers)	For 24 month child care leave	Income per family member below 25 per cent of average wage
Housing allowance	Average amount Zl 62 per month in 1995	Open-ended	Housing expenditures exceed a certain share of income; size of apartment below threshold; income per capita below minimum pension
Social assistance	Discretion of social worker	Discretion of social worker	Income per family member below minimum pension
Pensions			
Old-age	Depends on past earnings and number of insured years; indexation to CPI in 1996	Open-ended	Minimum contribution period 25 years for men and 20 years for women; age: 65 for men, 60 for women (but numerous exceptions)
Disability	Depends on past earnings and number of insured years; indexation to CPI in 1996	Open-ended	Damage to health
Survivor's	Depends on pension that the deceased would have received if applicable; indexation to CPI in 1996	Children: until age 16 (18 for school-goers); Widows: open-ended	For children and spouses Entitlement age for widows: 50, for widowers: 65

Memorandum items:
Ratio of minimum over average wage (net), 1995: 43 per cent
Ratio of minimum over average pension (net), 1995: 56 per cent

1. More generous provisions apply in some special cases, in particular in areas classified as distressed or for individuals with long work tenures.

Source: Central Statistical Office, Ministry of Labour and Social Affairs.

Table 20. **Finances of the main social security funds**[1]

In per cent of GDP

	1991	1992	1993	1994	1995	1996
Social Insurance Fund (FUS)						
Revenues	13.8	16.1	16.0	16.2	14.7	14.8
of which: Transfers from the state budget[2]	2.7	4.3	4.2	3.9	2.1	1.9
Expenditures	14.2	15.8	15.8	16.1	14.4	14.9
of which: Pensions	10.9	12.8	12.7	13.2	12.4	13.0
Social Insurance Fund for Farmers						
Revenues	1.9	2.0	2.1	2.4	2.3	2.3
of which: Transfers from the state budget	1.7	2.0	2.0	2.2	2.1	2.2
Expenditures	1.9	2.0	2.1	2.4	2.3	2.3
of which: Pensions	1.7	1.8	1.9	2.2	2.2	2.2
Labour Fund						
Revenues	1.5	2.0	2.0	2.1	2.2	2.0
of which: Transfers from the state budget	0.9	1.4	1.3	1.3	1.4	1.1
Expenditures	1.6	2.0	2.0	2.1	2.2	2.0
of which: Unemployment benefits	1.4	1.7	1.7	1.7	1.8	1.7
Total						
Revenues	17.2	20.1	20.1	20.7	19.1	19.1
of which: Transfers from the state budget	5.3	7.7	7.5	7.5	5.6	5.3
Expenditures	17.7	19.8	19.8	20.6	18.8	19.2
of which: Pensions	12.6	14.6	14.6	15.4	14.6	15.2

1. On a cash basis for 1991-95, and budget law for 1996. Excludes health. The pensions of the retirees of the law and order ministries do not appear in this table as they are paid directly from the state budget, and amount to about 1 per cent of GDP.
2. A change in the calculation of the state subsidy occurred on March 1, 1995.

Source: Ministry of Finance.

setting up their own business and concessional loans to firms creating new jobs.[77] As long-term unemployment spread, increasing attention started to be paid to the activation of the unemployed. The share of financial resources devoted to ALP in total unemployment expenditures grew slightly, from 11 per cent in 1993 to 12 per cent in 1995. Concomitantly, the annual inflow of participants in ALP schemes as a share of the labour force declined from 3.7 to 2.4 per cent. On those criteria, the role of ALP in Poland is analogous to what is observed in Spain but more limited than in other high-unemployment west European countries (OECD, 1995*f*). Within the 1995 envelope of ALP outlays, public works accounted for 30 per cent, employment subsidies for 50 per cent and training for 20 per cent.

During the 1980s, cash support to families with children played an increasingly prominent role. In 1989, virtually all families were made eligible for a flat

allowance per child equal to 8 per cent of the economy-wide average wage. During the first half of the 1990s, however, the real value of the benefit dropped sharply, owing to incomplete indexation, and in March 1995 family allowances were again subjected to a means-test. At the same time, it was decided to protect the real value of the family allowance from further erosion by indexing it on CPI inflation as projected in the budget (with an *ex post* adjustment if actual inflation is higher).

Social assistance is aimed at people living in extreme poverty. Permanent benefits are paid to those who due to age or a permanent disability cannot earn a living, while temporary benefits are paid mainly to the socially disadvantaged and the long-term unemployed who are no longer entitled to unemployment compensation. Until the end of the 1980s, the largest groups of clients of the social assistance centres consisted of elderly persons, disabled persons, multi-children families and families of alcoholics. The long-term unemployed have since become the largest contingent of clients. Social assistance is capped at 28 per cent of the average wage, means-tested and dispensed at the discretion of social workers. The temporary benefit, if granted, is limited in time, usually to 2-3 months and at most to 10 months. The system is administered locally, by the gminas, but mainly funded by the central budget. The number of permanent recipients of social assistance has increased continuously, from 88 000 in 1990 to 176 000 in 1995. In contrast, the number of people who in the course of the year benefited from temporary assistance grew from 0.8 million in 1990 to 2.5 million in 1993, but subsequently declined, to 2.0 million in 1995.

The current system of housing allowances was introduced in 1994. This benefit is paid to households with a per capita income lower than the minimum pension (or 150 per cent thereof for single person households), housing expenditures exceeding a certain fraction of income, and dwelling space not significantly exceeding 35 square meters for the first member plus 5 square meters per additional member. In 1995, 0.8 million households received housing allowances. Other cash benefits include maternity and child-care allowances. Besides the formal safety net, solidarity between family members, friends and neighbours, as well as the action of charities play an important role, as illustrated by the fact that in 1995, 16 per cent of the income of the social income recipients group consisted of gifts.

One of the main benefits in kind is health care. Formerly, health care was in principle universal and free, although in practice queuing for certain services and side-payments or gifts to medical staff were common. Over the past few years, households have been bearing a growing portion of medical costs, with the share of health expenditures in household budgets rising from 2.5 to 6.6 per cent between 1989 and 1995.[78]

Most enterprises continue to offer subsidised services to their employees, although not on so grand a scale as in the past, and more in line with practices in other OECD countries (Estrin *et al.*, 1995). They are most comprehensive in SOEs, where they still tend to involve expensive assets (housing, child-care facilities) but new private firms also offer some, such as health care packages. The importance of non-wage benefits may reflect hidden wage rises granted to avoid the excess wage tax applied earlier in the 1990s but is also a symptom of some of the deficiencies of the corresponding public services.

The current old-age pension system (for non-farmers) is still essentially a state-run, single-tier, pay-as-you-go scheme. Currently, the amount of a pension depends on the wage of the recipient during his last 7 years of work and the length of his work tenure. A floor is set at 39 per cent of the economy-wide average wage in the latest benchmark quarter.[79] The highest pensions fetch about 160 per cent of the nation-wide average wage. In 1995, the average gross pension amounted to 62½ per cent of the average wage, well above the levels in neighbouring countries (in 1994, they stood at 57 per cent in Hungary, 49 per cent in the Czech Republic and 42 per cent in Slovakia). The normal statutory retirement ages are 60 for women (55 provided they worked for at least 30 years) and 65 for men, but much lower in many professions (notably in mining, railways, education, journalism and arts). Moreover, large numbers of workers have been granted early retirement as an alternative to unemployment. Furthermore, and unlike in most other OECD countries, the income loss associated with early retirement is marginal. Lastly, pensioners are allowed to work, with the pension reduced only if they earn more than 60 per cent of the average wage (no pension is paid if they earn more than 120 per cent of the average wage). As a result, the average *de facto* retirement age in 1995 stood at only 57 years (55 for women and 59 for men), down from 59 years in 1989, and compared to an OECD average (in 1992) of 63 years overall (62 for women and 63 for men). In 1995, Poland counted 4.5 million old-age pensioners, of which 1.3 million individual farmers.[80]

Disability pensions are also used to some extent as a surrogate for outright lay-offs, and in 1995 were paid to 3.4 million persons. Eligibility rules are fairly lax, with damage to health instead of inability to work being the decisive criterion. The average retirement age for this category of pensions dropped from 49 to 46 years between 1989 and 1995. Survivor's pensions covered 1.2 million individuals in 1995 (mainly widows).

A well-designed social safety net should adequately target those most in need of protection in the short run, and discourage long-term dependency.[81] It should also be affordable. Targeting seems relatively successful but on the other two counts, as in many other OECD countries, the current arrangements are not fully satisfactory.

Partly as a result of the aforementioned (re-)introduction of means-testing for various benefits, non-pension social security transfers in general seem reasonably well targeted. For the poorest quintile of workers, the share of those transfers in total income stood at 16 per cent in 1995. Moving up the income ladder, the share declined to 10 per cent in the second quintile, 7 per cent in the third, 5 per cent in the fourth, and 2 per cent in the top quintile.[82] Pensions account for the bulk of cash transfers. In 1995, their share in the income of the top quintile of pensioners amounted to 80 per cent, versus 64 per cent for the bottom quintile. However, in so far as pensions ought to reflect past earnings and contributions, pensions inequality simply reflects (past) wage inequality. Moreover, the incidence of poverty is relatively low for pensioners. Unlike other social benefits, pensions are not merely insurance and redistribution tools, implying room for disagreement on how egalitarian they ought to be. Indeed, they should not be viewed in their totality as a component of the social safety net, as is implicitly acknowledged in the various reform proposals discussed below.

In contrast with the apparent success of overall financial targeting, it has turned out to be more difficult to foster the right incentives and to control the costs of social protection. The effectiveness and sustainability of the existing arrangements are examined in turn for unemployment, housing, health and pensions.

Unemployment

The coverage of the unemployment benefit scheme has been falling over time as eligibility requirements were tightened and as the proportion of the

unemployed having reached the maximum duration of benefits rose: between end-1991 and end-1994, the coverage rate dropped from 75 to 50 per cent. As the share of long-term unemployed receded, however, the coverage rate subsequently rose, to around 60 per cent in the second quarter of 1996. As noted, poverty and unemployment are strongly correlated. Unemployment benefits are relatively well targeted as attested by the fact that in 1995 they represented 4.5 per cent of the income of workers in the bottom quintile and 0.6 per cent of that of workers in the top quintile of the income distribution (with a steady decline from one intervening quintile to the next). At the same time, they accounted for 8 per cent of the income of the bottom quintile of the population as a whole, and for 28 per cent of the income of the social income recipients group.

Even for those unemployed who are not or no longer entitled to the allowance, registration with the labour office offers some advantages, especially free health services (including for the families of the unemployed), the accrual of ''contribution'' time for pension purposes, and training opportunities (Gora and Lehmann, 1995). Such quasi-benefits have prompted people who are out of the labour force to register as unemployed and benefit exhaustees to stay registered whether they are actually eager to find a job or not, thus imparting an upward bias to this unemployment measure, especially as regards its long-term component. Entitlement effects are also at work. There is a tendency to exit the register and take up a new job only just before the end of the entitlement period; while this effect is visible in many OECD countries, it seems to be particularly marked in Poland. Another entitlement effect is the growing phenomenon of half-year employment, encouraged by the small wedge between the unemployment allowance (36 per cent of the average wage in 1995) and the minimum wage (43 per cent of the average wage in 1995): individuals alternate 6-month work spells (just enough to qualify for unemployment benefits) and 12-month registration periods. Cross-hiring and firing of neighbouring farm family members at those intervals is not uncommon.

The assessment of the effectiveness of ALP is complicated by selection biases. The highest outflow rates to permanent employment are recorded for training and start-up loans, but some participants in those schemes would have found a job anyway, especially if selected on the basis of favourable personal characteristics and if they are strongly motivated. This is true in particular for the training of school graduates, who generally have a higher-than-average chance of

finding a job. Moreover, employment subsidies sometimes simply result in the displacement of incumbent workers or in substitution among job-seekers, without any net job creation.[83] Experience from other OECD countries suggests that both kinds of distortions – dead-weight losses and substitution effects – may indeed be significant. Other limitations of the ALP include the small number of enrolees in some programmes (notably re-training and start-up loans). Also problematic is the high cost of temporary public works positions (twice as much as the unemployment benefit), given that they do not significantly enhance participants' skills. The low subsequent job-accession rates of participants in public works (about 5 per cent) is another cause for concern. In contrast, the job-accession rate of participants in intervention works has increased over the past few years, exceeding 40 per cent in 1995. Finally, the payment of unemployment benefits to school-leavers, although it has been conditioned since early 1996 on their participation in training programmes (and re-labelled as stipends), may tend to postpone active job search. In principle, training for the young should be provided by the education system and not under the umbrella of the labour offices. The current arrangement possibly reflects genuine deficiencies of the education system, but is a second-best solution.

Since 1992, outlays related to unemployment have exceeded 2 per cent of GDP. Two thirds of the expenditures are financed from the state budget, and the remainder from employer contributions (payroll tax). The system is essentially based on social assistance principles in that the right to allowances and their amount are almost completely unrelated to the individuals' work and contribution history. This raises moral hazard and fairness questions: a compensation level close to the minimum wage tends to discourage job search on the part of low-income earners; and higher-income earners are only partly insured against unemployment risk even though they have contributed relatively more.

Accordingly, changes are under consideration that would give unemployment compensation more of an insurance character and that would put it on a more autonomous basis financially. The Ministry of Labour and Social Policy has proposed to restore the link with past earnings (which existed in the early 1990s). The length of the contribution period of the individual would also become a determining parameter. Compulsory employee contributions would be introduced and would, alongside employer contributions, finance an autonomous Unemployment Insurance Fund. The state's role would be confined to guaranteeing the

Fund's solvency and financing ALP programmes and the allowances paid to those who have not contributed (notably, graduates). One problem with an earnings-related approach is that it involves additional administrative costs, and possibly larger allowances (depending among other things on the composition of the pool of unemployed).

Housing and utilities

Turning to housing, means-tested allowances reach only half of the 15 per cent of targeted households, as many of the elderly who had been thought of as potential beneficiaries live in apartments built before the Second World War and therefore exceeding the surface ceiling (based on post-1945 construction norms) associated with this allowance. Moreover, gminas are not keen on advertising the allowance, since they fund half of it.

A related issue is the pricing of utilities. The prices of electricity, natural gas and district heating are still substantially below market levels (even though they are less far off than in some other transition countries). Blanket subsidisation is socially regressive in that it mostly benefits those who need it least, since it is proportional to consumption and consumption rises with income (Freund and Wallich, 1995).[84] For efficiency reasons, prices should continue to converge to long-run cost-recovery levels. In principle, it would be possible to protect the poor by targeted assistance offsetting the impact of increases in utility prices. In practice, this may be so costly administratively as to be infeasible. A second-best solution could be to introduce lifeline pricing, *i.e.*, to ensure a minimum volume at a low price and to charge a cost-covering price for any additional deliveries. Such an option has its drawbacks, however: the poor would not be the sole beneficiaries; some of the poor would not benefit (*e.g.*, farmers who do not consume district heating); some of the poor may have larger needs; and such a scheme offers no incentive to save for those who need less than the lifeline minimum.

Health

Regarding health care, major problems were apparent already in the 1980s despite the trend increase in the share of health spending in GDP (World Bank, 1994 and Ministry of Health and Social Welfare, 1996). The provision of care was over-centralised and scant attention was paid to costs, resulting in overlaps

and gaps, notably in the lopsided build-up of intensive care facilities and in over-specialisation at the expense of basic services, health promotion and disease prevention. Political patronage contributed to regional surpluses and shortages. Misallocation of capital translated in wasteful resource use, such as the use of general hospitals for geriatric care. As a result, Poland's relatively high average density of medical staff and equipment did not deliver a quality of health at par with that prevailing in western Europe.

Notwithstanding, the health status of the population improved in the early 1990s. Infant mortality dropped, from 19.1 per thousand in 1989 to 13.6 per thousand in 1995, in an acceleration of the downward trend already visible in the 1980s (Table 21).[85] Although the decline was steeper than in the other Visegrad countries, the level of infant mortality remained distinctly higher in

Table 21. **Health**

	1980	1989	1990	1991	1992	1993	1994	1995
Health status of the population								
Infant mortality (per thousand births)	25.5	19.1	19.3	18.2	17.3	16.1	15.1	13.6
Mortality (per thousand)	9.9	10.1	10.2	10.6	10.3	10.2	10.0	10.0
Life expectancy at birth:								
female	75.4[1]	75.5	75.5	75.3	75.7	76.0	76.1	76.4
male	66.9[1]	66.8	66.5	66.1	66.7	67.4	67.5	67.6
Health infrastructure								
Staff (per thousand inhabitants)								
Doctors	17.8	20.8	21.4	21.6	21.8	22.2	22.7	23.2
Dentists	4.7	4.7	4.8	4.6	4.3	4.4	4.5	4.6
Nurses	43.9	52.0	54.4	53.3	53.0	53.0	54.1	54.8
Pharmacists	4.3	4.2	4.0	4.2	4.3	4.6	4.9	5.0
Facilities (number)								
General hospitals	641	674	677	686	684	698	701	705
Out-patient clinics	5 819	6 682	6 584	6 306	6 037	5 995	6 210	6 473
Health centres	3 218	3 321	3 328	3 311	3 293	3 307	3 307	3 312
Pharmacies	3 245	3 555	3 957	4 690	5 106	5 689	6 179	6 536
of which: private	..	56	1 737	3 725	4 403	5 102	5 626	5 994
Expenditures on health (in per cent of GDP)								
Consolidated budget	..	..	..	5.0	5.1	4.7	4.7	4.7
of which: gminas	..	..	..	0.4	0.4	0.4	0.6	0.5
Households	..	0.2	0.4	0.7	1.1	1.6	1.7	1.6

1. 1980-81.
Source: Central Statistical Office, Ministry of Health.

Poland. Life expectancy also started to improve in 1992. Those positive developments reflected a variety of factors, including a drop in water and air pollution (Chapter IV) and healthier living habits, particularly regarding diets. In contrast, other indicators showed some deterioration (occupational accidents, certain infectious diseases).

Certain deficiencies have been growing in the health care sector during the first half of the 1990s, as attested by arrears in the settlement of health care expenditures by the budget, strikes and a rising recourse to informal side-payments, symptomatic of a need for reform. The latter is currently under way. In 1993-95, some 2 000 health establishments were transferred from the central to the local authorities. Conditions for legal self-governance and for the signing of contracts with the private sector were created. As of mid-1996, some 80 self-governing units had been set up and 700 contracts for the supply of health services had been signed with medical practitioners in private practices. In the spring of 1996, the Sejm was examining legislation that would create regionally-based, self-governing health funds financed by a 9.6 per cent contribution levied on wages. Performance-based contracts would be signed between the funds and the care providers. State funding, which thus far covered the bulk of expenditures, would essentially be confined to investments, training and research. The state would further be responsible for guaranteeing certain service standards. The aim of the reform is to promote a more efficient use of resources and the emergence of a market for medical services which would improve their quality through competition.

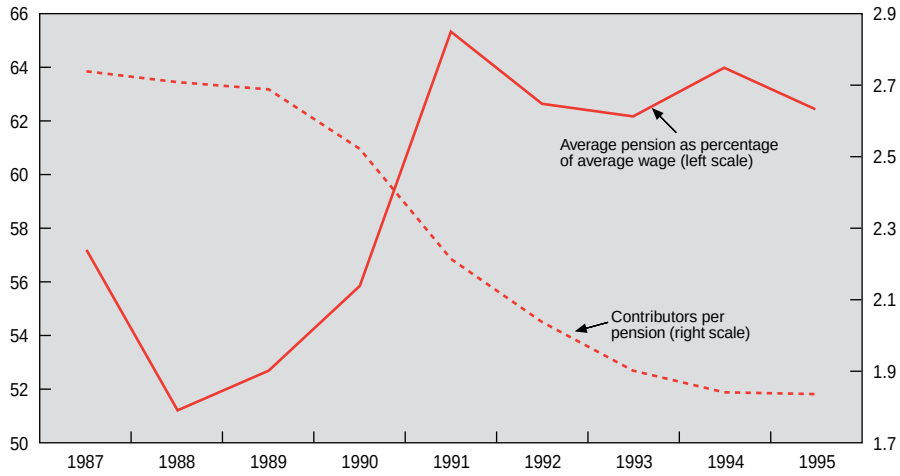
Pensions

In large part due to the way labour market pressures were absorbed, expenditures on pensions have soared during the first half of the 1990s. In addition to the large-scale recourse to early retirements and disability pensions to contain open unemployment, the generosity of pension adjustments caused the share of pension outlays in GDP to rise to some 16 per cent, compared with an OECD average of around 10 per cent, and exceeding the levels recorded in other transition countries (in the other Visegrad countries, the ratio stood at 10 per cent or less in 1995). This state of affairs is all the more alarming as the Polish population is relatively young. Demographic pressures will mount after 2005, when the baby boom generation born after the second World War reaches

retirement age: the share of women over 59 and men over 64, which currently stands at 13.5 per cent, is projected to increase to 19 per cent by 2020. The sharp decline in the number of contributors per pension (Figure 28) is thus likely to continue over the medium run, even if employment growth picks up.[86]

The authorities are well aware of the dangers looming, and pension system reform has been high on the list of priorities for several years (including in the *Strategy for Poland*). Notwithstanding, concrete steps so far have been few and not always aimed at reducing the pension burden. One of the changes introduced in 1994 was an increase in the minimum pension from 35 to 39 per cent of the average wage, another was to include all coal miners among the groups entitled to early retirement. The main restraining measure pushed through has been a temporary change in the indexation rule, namely the switch from a wage to a consumer price benchmark. This change had been envisaged for 1995 but was only implemented with effect in 1996 (Chapter I). In the absence of more comprehensive reforms, it might be extended to 1997.

Figure 28. **FACTORS UNDERLYING PENSION EXPENDITURES**



Source: Central Statistical Office.

Blue-prints for reform have not been in short supply. In the spring of 1996, two main approaches were under discussion. The first one was a proposal of the Ministry of Labour and Social Policy endorsed by the Council of Ministers in December 1995 and of which the Sejm approved the broad guidelines in April 1996. Although it involved some genuine changes to the current arrangements, it was essentially evolutionist in nature. The second one was put forward by the Ministry of Finance and involved much more radical changes.[87]

The first reform concept was based on three pillars, which after a phasing-in period of 15-20 years would lead to the following pattern:

- Some 70 per cent of their retirement income for those now aged less than 40 would continue to stem from general, mandatory insurance. The level of the pension would equal the number of contribution years times 2.1 per cent times the average earnings received during the individual's fattest 20 years, subject to a ceiling yet to be determined. The contribution would be levied on all wages up to 1.5 times the average wage but not above.
- Additional, voluntary insurance would account on average for about 20 per cent of their incomes as pensioners. This insurance would be offered by private pension funds (yet to be established).
- The remaining 10 per cent or so of their resources would come in the form of dissaving, with pensioners drawing on the resources built up independently, including in the form of life-insurance.[88]

The retirement age for women would be progressively raised starting in 2002, to reach parity with men at 65 in 2012. Early retirement would entail a more severe penalty than in the previous regime, and the rules governing the cumulation of a pension and a job would be tightened. The criteria for disability pensions would be stricter. Pensions would be indexed so as to rise at least as much as prices but less than wages, with specific indexation coefficients to be set by the Tripartite Commission. Social welfare support would be granted to anyone whose pension turned out to be below some minimum standard. Contribution rates would be increased for farmers, whose pensions are currently almost entirely paid for by the state budget. The main elements of the reform would be in place around 2000-02, after the key pieces of legislation among the 20-odd laws featuring in the pension reform package are enacted.

This first approach generated an average replacement ratio for the first tier approaching 80 per cent, *i.e.*, even more munificent than the present one. This seems unsustainable and would undermine the incentives needed for the two other tiers to develop. The viability of the approach would also depend on exactly how timely and significant the tightening of eligibility rules would turn out to be. Measures over and above those appearing in this first approach would include raising the retirement age above 65 years and lengthening the reference period in the calculation of the amount of the pension.

The Ministry of Finance in contrast proposed an almost completely funded system, along Chilean lines (de Fougerolles, 1995). A very modest first tier would be guaranteed to all, of only about 20 per cent of the average wage. Competing, private pension funds would be established through which the bulk of retirement saving would be channelled. They would be overseen by an independent non-government body. A large portion of pension income would thus be determined by individual contribution efforts and influenced by the performance of the pension funds. Participation in the second, funded tier would as a rule be compulsory. Furthermore, the share of the state in the financing of farmers' pensions would be decreased from the current level of around 95 per cent to 70-80 per cent.

If a system giving an important role to pension funds were to prevail, their initial capitalisation would be a major budgetary challenge for the years to come. One solution advocated by some in the government to bridge the existing and the future regimes would be to allocate the state-owned shares of several large industrial holdings or banks to those pension funds. Provided this is done in such a way as to ensure an equitable distribution of state wealth to all citizens, and not just to the participants in the pension funds, this could both speed up state divestiture and help solve the bridging quandary.

It seems that only some partial reforms are likely to materialise in the near future. Besides the incontrovertible need to decide on the indexation rule to be used in 1997, specific proposals have been fielded to restrict early retirement options for women, to condition the attribution of disability pensions on the capability to work rather than on health, and to increase farmers' contribution levels.

Any significant change in the pension system will involve some redistribution between the various groups of contributors and beneficiaries, and is therefore

likely to be vocally resisted. For example, the curtailment of exorbitant occupational privileges will be politically difficult. It can and has been done, however, for example in the Czech Republic. Pension reform is a vast and time-consuming endeavour, with major implications for inter-generational income distribution, for the development of saving and capital markets, and for macroeconomic performance in the short and in the longer run. This is a solid reason for starting early on. Indeed, buoyant growth has facilitated the stabilisation (and even slight decline in 1995) of the share of pension expenditures in GDP, and may have softened the sense of urgency attached to pension reform. However, the present window of opportunity will come to an end if growth slows down and in any event under the pressures of demography. Postponing the overhaul of the pension system will not only harm inflation performance in the short run and growth in the longer run, but also make reform even more difficult in the future.[89]

IV. Convergence in the longer run

Looking ahead after several years of rapid economic growth and financial consolidation and Poland's accession to the OECD, the question arises of the speed and modalities of convergence with the more advanced market economies. This chapter is devoted to some of the macroeconomic and structural dimensions of the prospective rapprochement.

Macroeconomic convergence

In April 1996, the government approved *Package 2000,* a medium-term macroeconomic programme covering the second half of the 1990s and elaborated in light of Poland's desire to join the EU.[90] One key objective of this programme is to sustain an average growth rate of 5½ per cent for real GDP. Export and import volumes would rise at an annual rate of 10½ per cent, with a slight deceleration over time. Gross investment would grow at 11 per cent per year, and consumption at close to 4 per cent. Year-end inflation is to decline to single digits by 1998 and to fall to 5-7 per cent by the turn of the century. Registered unemployment would decline to 10 per cent of the labour force, and the ratio of public debt to GDP would drop to 42 per cent in 2000. Although the document does not dwell at length on the policy framework that would bring about such favourable performance, indications are provided on fiscal orientations: the tax mix would continue to shift from direct to indirect taxes, the share of state government expenditures in GDP would be reduced by 2 percentage points, and the deficit of the state budget would gradually shrink, to 1½ per cent of GDP by 2000. This section discusses financial and growth prospects over this horizon and beyond.

Financial discipline and ''Maastricht convergence''

Increasingly, references are made to the Maastricht convergence criteria and, somewhat casually, to Poland's apparent compliance with the fiscal ones (see, *e.g.*, Council of Ministers, 1995). In this regard, it ought to be asked to what extent this is indeed the case, and, more importantly, whether such benchmarks are really relevant at this stage.

The Maastricht Treaty and the associated protocols set out four sets of convergence criteria for purposes of monetary union, namely: *i)* the achievement of a high degree of price stability, by comparison with CPI developments in the three EU countries with the lowest inflation rates; *ii)* the sustainability of the government financial position: the deficit ceiling is defined as 3 per cent of GDP and that for the public debt as 60 per cent of GDP (both subject to some qualifications); *iii)* the observance of ''normal'' exchange rate fluctuation margins for at least two years, without any devaluation against the currency of any EU member; and *iv)* the maintenance of nominal long-term interest rates no more than two percentage points above those in the three EU countries with the lowest inflation rates.

Although these criteria are commonly cited as if they spelled out rigid quantitative benchmarks, the relevant articles stipulate that there is room for judgement in the assessment of convergence. Also to be taken into account are the direction of change in these variables, as well as other elements, including balance of payments developments and progress with market integration. Hence, it is not straightforward to establish the extent of convergence.[91]

In the case of Poland, the fiscal criteria are the only ones that may seem relevant for the time being. With monthly inflation in Poland currently still on the order of annual price increases in the low inflation EU countries, and given inflationary inertia (Chapter I), the other three criteria would at best start to be of operational significance towards the end of the decade. As regards the formal fiscal criteria, the deficit of the general government, excluding privatisation receipts from the revenue side (in conformity with the EU framework of convergence), ended up a few tenths of a percentage point below the deficit norm in 1994 and 1995 (Chapter I), but will exceed it by about half a percentage point based on the 1996 budget projections. The criterion on general government debt has been met by Poland since 1995.

Even if the appropriately measured fiscal gap had been contained below the upper bound set by the Maastricht Treaty, it would be somewhat complacent to gauge the stance of fiscal policy by this measure. Firstly, the benchmark is a maximum, calling for a much smaller deficit at times of buoyant growth. Secondly, the depth of the financial system in Poland compares poorly to that prevailing in advanced market economies, meaning that the scope for non-inflationary deficit finance is more limited. Thus, ''over-achievement'' is necessary on the fiscal criteria for the other ones to become relevant in the foreseeable future.

Living standards and ''real convergence''

In the perspective of the rapprochement with the OECD and the EU, it is often asked where Poland currently stands in comparative terms and how long it would take for the Polish economy to catch up with market economies. The most frequently used measure invoked in this context is GDP per capita, sometimes valued at market exchange rates, and sometimes using estimated purchasing power parity (PPP) exchange rates. The answers vary a lot, depending on the vintage of the estimates and projections – in 1994-95, real GDP and the real exchange rate strengthened more than generally expected – and on the assumptions used for extrapolation from a given base. Different impressions are also conveyed depending on the selection of comparator countries.

Based on market exchange rates, and grossing up official GDP estimates by 10 per cent in order to take into account the hidden economy, GDP per capita in Poland in 1995 was only on the order of 15 per cent of the EU average.[92] Compared to Spain–the EU country which by its geography, demography, and the importance of agriculture comes closest to Poland – GDP per capita stood at almost one fourth. Comparing to the two poorest members of the EU, it stood at almost one third of the level in Portugal and Greece. At the same time, Poland's GDP per capita exceeded that of Turkey – the OECD's poorest member – by 14 per cent.[93]

To compare living standards, however, it is more appropriate to measure the size of the Polish economy using PPP exchange rates. On that basis, average living standards in Poland in the mid-1990s stood at about 30 per cent of the EU average, at 40 to 50 per cent of the levels in Spain,[94] Portugal and Greece, and 6 per cent higher than in Turkey.[95] Alternative indicators based on wealth rather

than income, such as ownership of consumer durables, suggest that average living standards in Poland rose very rapidly after 1989 and by 1995 may not have been far from those in Greece.

Looking ahead and speculating about the time needed for convergence with western Europe, the simplest arithmetic computations imply that full convergence is a matter of generations rather than of years.[96] For purely illustrative purposes, one could extrapolate into the indefinite future a 5 per cent growth rate in real GDP expressed in PPP dollars, and assume that this is twice the rate of growth in the countries presently members of the EU. Whereas fluctuations around trend growth are to be expected, an average long run rate of 5 per cent lies within the realm of historical experience. Indeed, such a pattern would be broadly in line with the record in Japan between 1960 and 1990, when GDP per capita expanded at 5.3 per cent a year against 2.7 per cent in the OECD, 2.8 per cent in the European Community, and 2.0 per cent in the United States (OECD, 1992*b*). It would also remain below the – admittedly outstanding – 6.7 per cent annual growth in GDP per capita recorded in South Korea over the same period. Taking into account demographic trends, full convergence would then occur only around 2040. It would be a more distant prospect still if the catch-up effect underlying the growth differential were asymptotically to vanish over time, as suggested by empirical cross-country studies of long-run growth trends (see, *e.g.*, Barro, 1991).

The gap between Poland and the EU measured using market exchange rates would probably shrink more rapidly in the short run, given the ongoing real exchange rate appreciation, but as noted above it was significantly larger to begin with. Assuming very rapid real exchange rate appreciation of 10 per cent per annum through 2000, GDP per capita in Poland at market exchange rates would rise to one fourth of the EU average and to close to 40 per cent of that of Spain by the end of the decade.[97]

External balance

The generous debt relief actions that were taken in support of Poland's adjustment and transformation efforts involve a gradual increase in debt service payments over the coming years, as the capacity to discharge these obligations grows, in line with the expansion of production and exports.

At the end of 1995, Poland's gross external debt amounted to $44.0 billion (37 per cent of GDP), down from $47.2 billion (55 per cent of GDP) at the end of 1993. It thus stood at the same level as the average recorded for Latin American countries. Out of the total external debt, 64 per cent was owed to Paris Club and 18 per cent to London Club creditors. Other large creditors included Russia (5 per cent) and the World Bank (4 per cent). Annual interest and amortisation payments on the existing debt are to increase from some $2.7 billion in 1996 to $4.5-5.7 billion in 2005-08, implying that as a ratio to exports of goods and services they will remain way below recent Latin American levels. The principal due to the Paris Club lenders will be repaid in gradually increasing instalments, peaking in the years 2005-09, and ending in 2014. Repayments on the London Club debt will be spread over the period 2001-24. In the short run, the implementation of the agreement with Russia on old bilateral debt obligations, coupled with rapid output growth and further real exchange rate appreciation, should bring down the gross external debt ratio to around 32 of GDP at the end of 1996.

In net terms, Poland's debt declined even more, from $37.2 billion at the end of 1993 (or 43 per cent of GDP) to $22.3 billion at the end of 1995 (or 19 per cent of GDP). This improvement is all the more genuine as only a minor fraction of the accumulation of foreign exchange reserves in 1994-95 was attributable to short-term capital inflows (Chapter I).

Servicing the inherited debt and containing the build-up of new liabilities will require that a sound external position be maintained. A healthy current account will also help improve Poland's credit standing and encourage non-debt creating capital inflows. Sustaining rapid export growth will be necessary to allow for imports to continue to contribute to the modernisation of the Polish economy. This in turn will require unit labour costs in foreign currency to increase at a slower pace than in 1995, through a combination of wage moderation, productivity gains and exchange rate flexibility. In this regard, containing non-wage labour costs will be equally important, and will in particular require the overdue reform of the pension system to actually materialise. A quantified analysis of competitiveness is complicated, however, by the existence of large unrecorded net exports (Annex II). The true current account position is much stronger than suggested – until 1995 – by the official balance of payments. However, the duality of the export sector – with a price elasticity for recorded

exports much higher than for those goods and services that are sold to cross-border shoppers – raises the spectre of a real exchange rate appreciation that would be unbearable for the officially recorded export sector.

Viewed from the angle of the saving-investment balance, sustaining the pace of capital formation that is envisaged in *Package 2000* calls for a continuation of the pick-up in private saving observed in 1994-95 and for further efforts at enhancing government saving. Attractive real interest rates will encourage household saving, and the envisaged reduction in the corporate income tax would bolster corporate saving. Social security reform and the phasing out of subsidies should underpin the increase in public saving. Continued improvements in the efficiency of financial intermediation will stimulate both domestic saving and investment.

Structural realignments

If Poland is to catch up with advanced market economies through faster long-run growth, the ongoing process of opening-up will have to be sustained.[98] Remaining impediments to trade and capital flows will need to be phased out. At the same time, convergence towards and integration with the advanced market economies requires a fair degree of legislative harmonisation.[99] On all these fronts, much progress has already been made. The commitments under the Uruguay Round and Europe Agreement in particular involve major cuts in trade barriers. In the context of accession to the OECD, capital flows are also being liberalised. More generally, all new laws are screened for compatibility with EU legislation while existing ones are to be gradually reviewed and amended in the same direction. This applies in particular to environmental legislation. Faced with a dismal ecological legacy, Poland has taken resolute measures which have helped reduce pollution levels considerably. However, bringing those down all the way to EU levels will be an expensive and long-lasting process.

Integration through trade

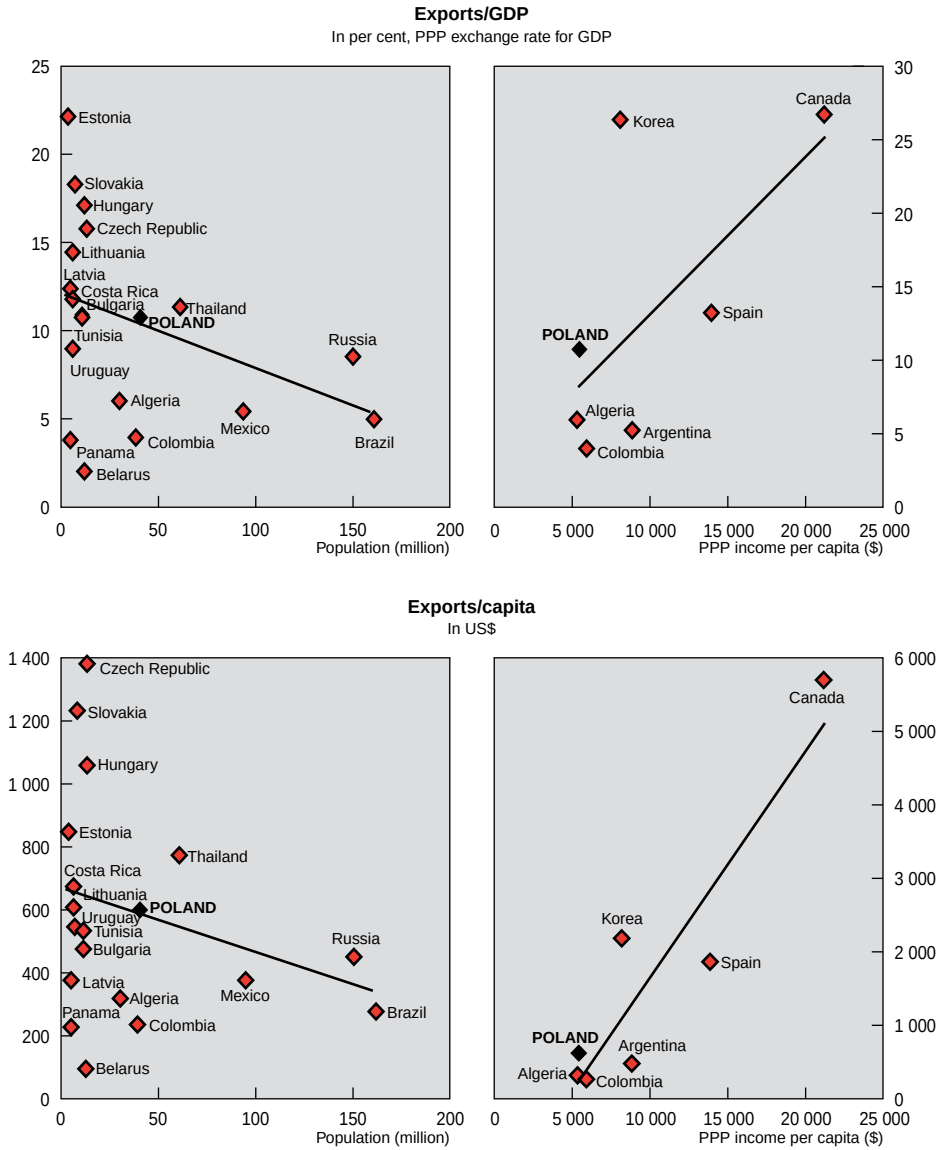
During the first half of the 1990s, foreign trade expanded rapidly, and its composition shifted dramatically (Chapter II). Between 1990 and 1995, annual per capita recorded trade in goods and non-factor services (exports plus imports) rose from less than $600 to close to $1 400. At the same time, trade rose from

14 to 23 per cent of GDP measured in PPP terms. By 1996, Poland's share in world trade is projected to come close to its share in world population (0.7 per cent).[100] Likewise, the rapid expansion of exports brought Poland close to where its size (population) and income level (PPP per capita GDP) would predict based on cross-country experience (Figure 29). At the same time, the share of EU partners in Poland's external trade was already more important than for several EU countries themselves, underlining the integration with western Europe.

Fostering the swift expansion of Polish exports and imports, particularly trade with the EU, is the gradual lowering of trade barriers. Exports are being facilitated by the phasing out of EU tariffs on Polish exports that began in 1992 with the abolishment of duties on almost half of Poland's industrial exports to the EU. By January 1995, around 70 per cent of Poland's industrial exports – which represent some 85 per cent of total (recorded) exports – benefited from duty-free access to the EU market. This privilege was extended to steel products in January 1996, and should encompass textiles and clothing as well from January 1997 (however, voluntary export restraints in the latter sector will only be lifted one year later). Among the remaining barriers to exports to the EU are anti-dumping actions, mainly affecting the metallurgical and chemical sectors.[101] In addition, there are some self-imposed export quotas, such as for raw skins and metal scrap (however, Poland agreed in early 1996 to relax some of those export restrictions), as well as some export licensing requirements (for petroleum products, dairy items, and textiles). Access to the EU market for Poland's agricultural products is only partly liberalised, and new negotiations, entailing reciprocal measures on the Polish side, are needed for further liberalisation.

On the import side, the Uruguay Round led Poland to bind 96 per cent of its tariffs on industrial goods (exceptions include motor vehicles, automotive components, oil and some textile products) and, after tariffication, all tariffs on agricultural products.[102] The phasing out of tariffs stipulated in the Europe Agreement started on the Polish side with the abolishment in 1992 of customs duties on one quarter of industrial imports (especially capital goods and raw materials), and is being followed by a series of cuts in the remainder spread out over the second half of the 1990s. From 1999, most imports of industrial goods from the EU should thus enter Poland duty free.[103] Tariffs on imports from the other countries of the Central European Free Trade Association (CEFTA) are also subject to accelerated cuts. As a result, the trade-weighted average tariff for industrial goods

Figure 29. **OPENNESS TO TRADE**[1]



1. Data for 1994 except for Poland (1995).
Left panels: countries with per capita income in the same range as Poland.
Right panels: countries with a population in the same range as Poland.
Source: World Bank, IMF, OECD.

Table 22. **Import tariffs**

Beginning-of-year, weighted average customs duties, in per cent[1]

	1994	1995	1996	1997	1998	1999	2000
Agricultural products	20.04	19.52	20.17	19.77	19.37	18.98	18.60
Industrial products	18.38	14.49	9.78	4.92	3.58	2.50	2.15
Combined	19.48	16.30	11.03	6.70	5.47	4.48	4.12
of which: Import surcharge	6	5	3	0	0	0	0

1. The rates overstate actual tariffs in so far as they abstract from tariff suspensions, which as of January 1996 were equivalent to about one percentage point.

Source: Ministry of Foreign Economic Relations, *Package 2000.*

declined to 9½ per cent in January 1995 and 6¾ per cent in January 1996 (Table 22). In the case of agricultural products, the average import tariffs remain much higher, partly due to the conversion of non-tariffs into tariffs. Under the Uruguay Round Agreements, agricultural tariff ceilings are to be reduced by 36 per cent in six annual instalments from 1995, but given that for most items the ceilings are not binding, actual tariffs rates may not fall as much. In parallel with these tariff adjustments, the broad-based import surcharge that had been introduced for balance of payments purposes in 1992 is being phased out in steps, and is scheduled to be cancelled altogether in January 1997. A number of non-tariff provisions also apply, including tariff quotas linked to preferential agreements (*e.g.*, on cars and on selected agricultural products from the other countries of the CEFTA) or to domestic restructuring measures in certain sectors (*e.g.*, electronics, plastics, car components and medical equipment). In addition, there are market access quotas (*e.g.*, on alcoholic beverages, cigarettes and petroleum products), licensing requirements (*e.g.*, on fuels and dairy items) and outright prohibitions (such as on hazardous substances and old cars). Furthermore, safeguard measures were temporarily applied to some NIS countries on imports of urea. For services, market access is being eased more slowly, with full liberalisation envisaged only by end-2004.

The general trend of reducing import barriers was interrupted by the introduction of variable import levies on 8 types of food and agricultural products in June 1994 (representing 6 per cent of agro-food imports). These levies were abolished in July 1995, in line with Uruguay Round commitments. In April 1996, however, the economic committee of the Council of Ministers approved a set of

precautionary regulations prepared by the Ministry of Agriculture which could be used (after a delay of 60 days) to protect domestic producers against import surges. The associated list of imports on which additional duties could be imposed included *inter alia* pork, cucumber, wheat flour and rye flour (these items had been subjected to variable levies earlier on), and products such as butter and potato starch, deemed to play a major role in the market and for which domestic supply was judged sufficient.

Also offsetting the aforementioned trend were the re-introduction of customs duties on imports of telecommunications equipment from the EU in 1994, and the increase of tariffs on imports of petrochemicals in January 1996, both on the basis of the restructuring clause of the Europe Agreement. In the fall of 1995, the Ministry of Industry and Trade was pushing for the cut in import tariffs for steel foreseen for 1998 by the Europe Agreement to be postponed, again on the basis of the restructuring clause. Moreover, in April 1996, the Ministry proposed to reintroduce a 6.6 per cent import duty on paper in order to protect domestic producers. Furthermore, mandatory quality certificates for some 1 400 types of imported manufactured goods were introduced in early 1996, in the name of consumer protection but possibly also in an effort to shelter domestic producers, prompting some importers to complain about the implied delays and costs. This requirement should become less of an obstacle in the future, once the necessary legislative adjustments have been introduced allowing importers to avail themselves of quality certificates delivered in the EU.

Also running against the need to level the playing field and to optimise resource use was the authorisation granted in the Spring of 1996 to the Korean conglomerate Daewoo by the Ministry of Industry and Trade and the Ministry of Foreign Economic Relations to import some 110 000 disassembled automobiles free of duty in 1996-97. In order to circumvent the standard 35 per cent import duty on finished cars, Daewoo had decided to knock down in Slovenia the new vehicles delivered from Korea and destined to the Polish market, so as to ship them in kits and as car parts across the border and to rebuild them in Poland. The Polish Customs administration intervened to try and impose the import duty in what was a clear breach of the spirit, if not the letter, of the rules. However, concerns about the fate of the large investment projects envisaged by Daewoo in Poland apparently led the government to overrule this attempt. Admittedly, a large number of individuals and small companies also make use of the legislative

loophole, to the point that auto shops specialising in the disassembly and re-assembly of cars have cropped up on both sides of the western and southern borders.

In addition to the impact of tariff and non-tariff barriers, the expansion of trade may also be constrained by an underdeveloped infrastructure, both at the borders and within Poland. The capacity of the border posts in place in the early 1990s was far from sufficient to accommodate the subsequent surge in traffic (Table 23). Therefore, 36 border posts were opened during the first half of the 1990s, while existing ones were modernised. Concomitantly, the staff of the customs administration tripled. At the same time, customs clearance procedures are being moved from the border to other places in Poland, which should help unblock border crossings and provide for proper control of goods and collection of duties and taxes. Even so, bottlenecks persist, especially on the eastern border, as improvements on the other side tend to lag.

For Poland to make the most of its central geographical location, and in light of the rapid expansion of traffic – especially that of heavy trucks – traffic

Table 23. **Border posts and crossings**

	1989	1990	1991	1992	1993	1994	1995
Number of border posts							
Roads	<— 88 —>		<——— 90 ———>			102	113
Railways	<— 29 —>		<——— 30 ———>			31	33
Sea	<— 13 —>		<——— 15 ———>			16	17
Rivers	<— 6 —>		<——— 6 ———>			5	5
Air	<— 4 —>		<——— 4 ———>			7	8
Number of crossings (millions)							
Persons	54.1	79.3	113.9	154.1	183.0	215.2	234.9
Trucks	0.70	1.08	1.56	1.86	2.19	2.72	2.79
Passenger cars [1]	7.5	11.7	22.2	33.2	47.8	61.5	66.9
Buses [1]						0.52	0.56
Memorandum items:							
Number of persons employed in the Customs Administration	3 913	4 465	6 810	7 848	10 462	11 186	12 525
Number of exporters [2]	697	1 690	1 735	30 084	33 059	38 812	41 929
Number of importers [2]	603	1 095	1 158	81 501	78 310	72 332	74 154

1. Until 1993, buses and cars were lumped together.
2. Foreign trade companies and entities authorised to carry out foreign trade operations (excluding physical persons).
Source: Central Statistical Office, Customs Administration.

conditions within the country also call for substantial improvement. In a number of areas, maintenance and rehabilitation backlogs account for the poor state of the existing roads and bridges, and contribute to a comparatively poor safety record. There is also a dire lack of highways. A Law on Toll Roads went into force at the beginning of 1995 codifying the construction of 2 600 kilometres of toll highways over the next 15 years. The project would be mainly financed by the private sector, which would thereby acquire the right to operate those highways for some time and to receive the associated revenues. The state would only cover some 15-20 per cent of total costs, principally through the provision of the land. At the same time, new urban bypasses are being constructed and existing roads upgraded. The railway infrastructure is also being modernised, *inter alia* to allow faster train traffic. Furthermore, work is underway to improve the throughput efficiency of maritime ports, which suffers from inadequate connections with the inland transport system.

Integration into the global capital market

Capital inflows have picked up significantly since late 1994 (Chapter I). Foreign direct investment gathered pace, as did portfolio investment (which became large enough to start being identified as a separate item in the balance of payments in 1995). Moreover, new forms of inflows appeared as Poland re-entered the international capital market.

Foreign direct investment inflows rose rapidly, from $77 million in 1990 to $1.7 billion in 1993, but declined in 1994, to $1.3 billion,[104] partly due to the bursting of the stock market bubble and to the uncertainties surrounding privatisation and external debt rescheduling at that time. They almost doubled, however, in 1995, to $2.5 billion (or 2.1 per cent of GDP), as much of the uncertainty had been lifted and current account convertibility (in the sense of the IMF's article VIII) was established. The authorities expect a further increase to at least $4 billion (2.9 per cent of GDP) in 1996. The stock of foreign investment accrued since 1990 reached $10.2 billion in July 1996.[105] On top of this, $8.0 billion had been officially committed by foreign investors. The number of companies with foreign participation increased from fewer than 16 000 end-1993 to over 26 000 in mid-1996.[106] The bulk of foreign direct investment is in industry, and one fourth is concentrated in and around Warsaw. About 24 per cent is held by investors from the United States, and about 13 per cent by investors from

Germany. Growing interest on the part of Asian investors is perceptible. For non-European investors, FDI in Poland indeed offers the prospect of better access to EU markets. Whereas in 1990-92 most of the foreign direct investment took the form of participation in privatisation operations, greenfield and brownfield projects became more important from 1993, as did the purchase of shares in private businesses.[107] Among the largest operations since 1994 are undertakings in the automobile, food processing and financial sectors.

Despite the sharp rise of late, foreign direct investment in Poland remains relatively modest, lagging far behind Hungary, the Czech Republic and Estonia in per capita terms. The contrast is all the more striking as opinion polls reveal that an increasingly vast majority of the Polish population welcomes foreign investment, recognising its contribution to job creation and to the modernisation of production methods (although perceiving it at the same time as a source of potentially lethal competition for some of the Polish producers). Surveys of foreign investors suggest that inhibiting factors include legislative uncertainty (and the strong reservations expressed by certain politicians), taxation levels, and until recently at least such impediments as the 1920 Law governing purchases of real estate by foreigners which requires the latter to obtain a permit from the Ministry of the Interior (and in some cases the green light from other ministries as well).[108] While analogous complaints are frequently lodged against many other investment destinations, including in transition economies, the size of the inflows into Poland suggests that in the first half of the 1990s political, regulatory or bureaucratic obstacles have significantly offset the attractiveness of a large and rapidly expanding domestic market.

A number of measures have been taken in order to facilitate entry. For example, the rules applying to purchases of real estate by foreigners were eased in May 1996, albeit with some reservations regarding agricultural land. At the same time, a series of amendments to the Law on companies with foreign participation – which governs foreign direct investment – broadened the scope of national treatment by removing permit requirements for foreign investors in a number of sectors. Besides, the Polish copyright law that became effective in May 1994 should help attract foreign investment by offering better protection of intellectual property rights.

Although much smaller, Polish foreign direct investments abroad are growing, with the stock reaching $328 million at the end of 1995. For example,

foreign trade companies have been setting up or buying stakes in distribution networks in Germany, and Polish firms have become significant investors in Lithuania, Romania and the Russian Kaliningrad enclave. Outward direct investment operations up to Ecu 1 million were liberalised in January 1996 for businesses, as were outward real estate investments up to Ecu 50 000 per person.

New forms of portfolio inflows appeared even as existing ones such as purchases of domestically-issued Treasury paper picked up. Noteworthy was the issue of a five-year $250 million eurobond in mid-1995, which marked the re-entry of Poland in the international financial markets, following the attribution of an investment grade rating by Moody's. The issue was priced to yield 185 basis points above US Treasuries, meaning that Poland achieved better terms than other borrowers with similar credit ratings. By mid-1996, the offered spread *vis-à-vis* US Treasuries was down to only around 70 basis points, *i.e.*, in the same range as for similar Greek eurobonds. Furthermore, Polish companies have started to launch American depository receipts (ADRs) and global depository receipts (GDRs).[109] Such operations enable Polish entities to obtain better prices for their shares, to limit domestic ownership concentration levels and to advertise themselves abroad. A number of municipalities have also announced their intention to issue bonds on the international capital market. The first one was carried out by Gdynia in early 1996.

Outward long-term portfolio investments on recognised markets in OECD countries were made easier for enterprises and individuals in early 1996. At the same time, payments and transfers in foreign exchange by citizens, which had already been freed for current account transactions by the 1994 Foreign Exchange Law, were also liberalised further.

The scope and magnitude of capital in- and outflows is likely to increase considerably in the course of the second half of the 1990s, as remaining restrictions are gradually relaxed with a view to achieve full capital convertibility by 2000, and as the physical and financial infrastructure in Poland is further modernised.

Clean-up and greener growth

Since 1989, Poland has strived to reduce high levels of pollution and environmental damage. The government's 1991 National Environmental Plan was a key component of these efforts. This plan has been updated in the context

of the Association Agreement with the EU, with Poland taking on the commitment to ''harmonise'' its environmental standards with EU directives (OECD, 1995*b*). Although substantial progress has been achieved thus far, much remains to be done, especially in light of recent and foreseeable rapid growth.

Pollution levels declined quite spectacularly in the early years of the transition, with palpable benefits for public health (as attested by significant improvements in morbidity rates). A major factor underlying this drop was the sharp fall in aggregate production. However, even as the recovery took hold, further improvements were noticeable. One reason was the shift in the composition of output towards ''cleaner'' sectors, particularly services (Chapter II). At the aggregate level, household energy consumption also involved beneficial fuel substitution, from coal to gas (poorer households, however, sometimes switched to cheaper and more toxic types of coal). The introduction of more stringent environmental regulations, backed by stiff fines, also helped, prompting the use of less polluting inputs and the adoption of less harmful technologies. End-of-pipe investments to protect the environment doubled between 1989 and 1993-94, to 1.0 per cent of GDP.[110] For instance, coal washing plants were set up which remove sulphur from hard coal, thereby lowering air pollution. The importance of such investments is reflected in a comparatively large, sophisticated and dynamic market for environmental goods and services, with as many as one thousand domestic and one hundred foreign environmental companies operating in Poland (Macek and Basjarowicz, 1995). A number of highly polluting facilities, such as some power generating plants using low quality coal, were shut down. A training programme for production managers was also established by the government to encourage low-cost investments improving productivity and cutting easily avoidable emissions, discharges and waste.

As a result, even as output grew again, the toll of industrial activity on the environment declined. Between 1991 and 1994, the emission of dusts fell by 17 per cent, that of sulphur dioxide by 13 per cent, and that of nitric oxide by 8 per cent (Table 24). During the same period, the amount of industrial waste declined by 6 per cent, and that of waste stored in the environment by 12 per cent; in 1995, however, both picked up by 1½ per cent. Furthermore, water usage declined continuously: in 1995, it was down 7 per cent on 1991. Lastly, between 1989 and 1995, the amount of untreated sewage dropped by 54 per cent,

Table 24. **Selected environmental indicators**

	1989	1990	1991	1992	1993	1994	1995
Emissions (in thousands of tonnes)							
Dust	2 425	1 975	1 707	1 608	1 522	1 423	. .
Sulphur dioxide	3 910	3 210	2 995	2 820	2 725	2 605	. .
Nitric oxide	1 480	1 280	1 205	1 130	1 120	1 105	. .
Water							
Usage (hm^3)	14 580	13 590	12 548	11 820	11 571	11 618	11 698
Sewage							
Amount untreated (hm^3)	1 550	1 343	1 134	995	844	809	700
Share of biologically treated in total treated sewage (per cent)	37.9	39.5	41.8	45.6	48.7	50.2	52.4
Share of the urban population serviced by treatments plants (per cent)	. .	. .	55.6	56.7	59.7	62.2	66.1
Industrial waste (millions of tonnes)							
Generated	170.9	143.9	128.3	121.9	120.5	120.9	122.7
of which: stored in landfills	73.2	66.5	62.3	57.1	55.5	54.7	55.5

Source: Central Statistical Office.

the share of biologically treated sewage increased by 15 percentage points and that of the urban population serviced by sewage treatment plants increased considerably as well.

Most of the environmental expenditures are paid for by polluters and users, in the form of charges and fines, which are typically higher than in other OECD countries. Economic incentives play a major role in environmental policy. They include fees for the withdrawal of water and discharge of wastewater, emissions into the atmosphere, disposal of waste and other forms of using the environment. Fines are levied on emissions exceeding regulatory standards. There are also some tax allowances, for instance to encourage the utilisation of recycled materials, and taxes are differentiated across substitutable energy sources, for instance with lower taxes applied to lead-free gasoline. In 1994, about 40 per cent of environmental expenditures were financed by polluters via the payment of fees and fines to extra-budgetary funds. More than 30 per cent were financed by polluters directly from their own resources. Less than 30 per cent of expenditures were financed from (central and local) government budgets (Zylicz, 1996).

Financial innovation is also facilitating the needed investments: some $460 million, to be spent in 1992-2010, were earmarked for eco-conversion by several Paris Club creditors, in what constituted the first debt-for-environment swap involving public debt. The associated resources are used to subsidise (on average to the tune of 25 per cent of the cost) investments in environment protection, involving some 200 projects in 1992-95. Qualifying activities are those for which environmental expenditures in Poland can bring larger global benefits than would the same amounts spent in other OECD countries. Examples include actions to reduce transfrontier air pollution, nutrient pollution of the Baltic sea and emissions of greenhouse gases.

Notwithstanding tangible improvements over the past few years, ecological welfare standards remain relatively low in Poland. In 1994-95, the levels of resource intensity and pollution of the Polish economy (per unit of GDP computed at PPP exchange rates) were considerably higher than in OECD countries, by a factor of two for water and energy intensity, by a factor of three for municipal waste and the emission of nitrogen oxides and carbon dioxides, and by much higher factors for the emission of sulphur dioxide and particulates. Water treatment is under-developed, with only 39 per cent of the population benefiting from treatment plants, compared with around 90 per cent in western Europe, and about half of the rural population drinking unhealthy water. Only 55 per cent of the population is served by municipal sanitation services, while in western Europe the coverage is usually over 90 per cent. High emission levels mainly reflect the continuing importance of heavy industries, such as metallurgy, and the extensive reliance on coal combustion for heating and electricity generation (about 90 per cent of electricity output continues to be derived from coal-fired power stations). Coal mines continue to cause major environmental damage, and often refuse to pay fees and fines, particularly on the discharge of saline waters.[111] Poor air quality remains a serious threat to human health in industrialised cities. Acid deposition is still very high, especially near the German border (due to transfrontier pollution), and Polish forests are among those suffering most in Europe (OECD, 1995*b*).

On current policies, and even if economic growth is sustained at the rate envisaged in *Package 2000,* further progress in reducing absolute pollution levels can generally be expected, except perhaps for nitrogen oxides (which are chiefly caused by road traffic). Continued progress would result from the continuation of

the sectoral shifts towards cleaner sectors. Coal output in particular is projected to fall significantly (Chapter II). The far-reaching environmental laws and regulations already in place in Poland should further reduce the pollution stemming from the use of the existing capital stock and, crucially, will ensure that newly installed capital is ecologically much less harmful. It is expected that the emission of sulphur dioxide for instance will be reduced drastically over the next few years, as new plants coming on stream after 1998 will be required to have emission levels 75-80 per cent below current levels. Beyond the end of the decade, however, a pick-up in pollution could be expected in the absence of new measures.

Policy actions under consideration to make further progress in this area comprise raising some of the existing fees, for instance the one on emissions of carbon dioxide, which was launched in January 1995 (with a modest rate). Following the creation of a plastic container tax in July 1995, new taxes on phosphates, detergents and other chemicals are envisaged. Voluntary eco-labelling schemes have been put forward, as have compulsory deposit/refund schemes for certain items (so far, only voluntary ones exist). Analysis is under way to introduce more efficient charging schemes for municipal solid waste disposal, and to install more water meters in order to better measure and bill household consumption.

The government in 1995 also adopted a ten-year programme to insulate some five thousand buildings per annum. In this context, it is envisaged to set up specialised companies, partly financed by the National Energy Conservation Agency, which would contract with consumers to modernise their energy systems. The consumer would continue to pay an unchanged energy bill for a number of years even though his consumption would decline as the insulation is put in place; however, at the end of a pre-determined period, the consumer would own the new equipment and start saving on his energy bill. Hospitals for example are thought of as potential candidates for this scheme.

Among the other novel approaches under discussion is the introduction of tradable pollution permits. No legislative framework has yet been adopted in this regard, but an encouraging pilot experiment was launched in 1992 in Upper Silesia. Two highly polluting plants, a power station and a steel mill, were identified as ‘‘trading partners’’. The power plant was not complying with existing pollution standards, but was scheduled for retirement by the end of the

decade, making the multi-million dollar modernisation investment needed to ensure compliance inefficient. The steel mill could comply with the pollution standards and even do better at the expense of relatively minor investments, but the prevailing levels of fees did not provide it the incentive to do so. In this instance, joint (over) compliance was achieved thanks to a transfer of pollution rights to the power station, used to finance the abatement effort in the steel mill. Generalising such arrangements, however, requires a solid institutional framework, and may involve substantial administrative and transaction costs. An added complication arises from a recent EU directive on integrated pollution prevention and control viewing permits as composite contracts and thus possibly reducing their tradability.[112]

Another avenue under exploration involves alternative energy sources, including wind power, hydroelectricity, solar and geothermal energy.[113] For some local authorities, the switch may be quite attractive as it can involve substantial subsidies. However, the physical potential for wind power seems modest, as does that for hydroelectricity. Solar energy appears prohibitively expensive, given Poland's climate. A geothermal plant is operating in Pyrzyce and is claimed to be financially competitive with traditional coal-fired heat plants if the cost of waste-treatment is taken into account. Another geothermal project is underway in Zakopane. There are some rich geothermal water deposits in several Polish regions, but doubts linger about the renewability of this source (which under certain conditions can turn out to be an exhaustible resource). Moreover, the vested interests of the coal industry conflict with the development of geothermal energy.

In sum, convergence with West European environment standards cannot be expected in the near term and will require major investments in addition to those that have already been undertaken. The scarcity of natural resources (including of water) and the importance of ecological externalities can hardly be overstated, if rapid growth is to be sustained.

Notes

1. In contrast, the size of the 1990-91 output collapse is probably exaggerated by the official data that have long been used (Czyzewski *et al.*, 1996). The Central Statistical Office recently proposed a rough re-estimate for the decline in 1990, of 7-8 per cent (instead of 11.6 per cent).
2. For details on agriculture, see Annex I.
3. It does not necessarily follow that, at a more disaggregated level, the specific items produced were of the highest technological caliber.
4. Outward processing also takes place in the opposite direction, with Polish agricultural products sent to Germany, processed there, and re-imported.
5. However, such unused privileges represented less than 3 per cent of Polish exports to the EU (Foreign Trade Research Institute, 1995*a*).
6. In 1994, the EU launched an anti-dumping procedure against cement produced in Poland. This action failed, as it turned out that the EU market itself was cartellised. The dispute was essentially one between German producers churning out cement on opposite sides of the Oder.
7. Precise dollar wage comparisons would be potentially misleading, as wage concepts differ across countries.
8. Consumption wages rose less, as consumer prices outpaced industrial producer prices (see below).
9. Data for firms employing over 50 persons in manufacturing and mining, and over 20 in other sectors. Loss-making firms saw their losses shrink over this period, from 12.3 per cent of gross turnover in 1993 to 8.5 per cent in 1995.
10. Chapter III discusses unemployment issues in much more detail.
11. An alternative interpretation could be that capacity utilisation increased. On available measures, it did, but only marginally so. However, measuring capacity is problematic when part of the stock of production factors can no longer generate positive value-added.
12. It should be borne in mind that, notwithstanding the legal requirement to declare vacancies to the labour office, and like in some other OECD countries, registered vacancies amount to less than half of actual job openings (Witkowski, 1995).
13. This source suggests a slightly earlier turnaround, partly because of the fact that registration data tend to reflect exits to jobs with a lag.

14. For 1995, the government agreed, in order to secure the budget's approval by Parliament, to adjust budgetary wages *ex post* to take into account actual inflation, thus accentuating backward-looking indexation. Moreover, until recently the economy-wide minimum wage was adjusted quarterly (it is now adjusted on a half-yearly basis).

15. As a result, a minor deviation of the wage from the projected path, which would only marginally affect contribution revenues, could have a major impact on pension outlays. For example, given that pensions absorb some 16 per cent of GDP, a 10 per cent adjustment advanced by one quarter would increase outlays in that year by close to 0.4 per cent of annual GDP.

16. In early 1996, a controversy arose on the applicability of the indexation rule with respect to wage developments in the last quarter of 1995. In July, the Constitutional Tribunal decided that it did apply.

17. The change in other items net had a negative weight of 29 per cent in 1994 and 44 per cent in 1995.

18. In this report, all nominal magnitudes expressed in national currency are in new zlotys, equivalent to 10 000 old (pre-1995) zlotys.

19. This share is a second-best and downward biased measure of the degree of ''dollarisation'' of the economy, since it ignores cash foreign exchange circulating in the country, which cannot be readily quantified.

20. Somewhat offsetting the impact of this portfolio roundtrip, however, was the temporary reduction in float and implied hike in the money stock at the end of 1994 associated with the redenomination operation.

21. The mid-points of the published interest rate ranges are used in this calculation.

22. Penalty interest accrues on tax and social security arrears, at a daily rate, in early 1996, of 0.14 per cent.

23. These arrears on social security contributions do not directly affect the general government deficit, but only its distribution among levels of government.

24. The large negative contribution of foreign finance in 1994 reflects the upfront outlays associated with the foreign debt reduction operation.

25. Insofar as debt relief stimulates growth, the total impact may be larger.

26. Although the zloty appreciated by 9 per cent in real, CPI-based terms *vis-à-vis* the dollar in 1994, the weakening of the US currency against the other currencies in which the external debt was labelled almost completely offset the impact of the strengthening of the bilateral zloty/dollar real exchange rate on the debt ratio in 1994.

27. Infra-annual national account estimates were unofficial and highly tentative until 1996, when the Central Statistical Office (GUS) started quarterly national accounting, on an experimental basis (Chmiel and Gorska, 1995).

28. On education, see OECD (1996*d*). On science, see OECD (1996*a*). On health care, see Chapter III.

29. The financial obligations resulting from the other rulings of the Constitutional Tribunal concerning wages in the public sector and pension adjustments are likely to be settled in the form of compensation vouchers.

30. A gradual slowdown in the rate of crawl, roughly in line with the deceleration of prices, underpins this projection.

31. See Chapter IV for further details on the macroeconomics of *Package 2000.*

32. Currently, the voivodships are already in charge of some 3 000 SOEs.

33. Shares are not strictly comparable, referring to GDP in 1989 and to gross value-added in 1995.

34. Since the convention is that any enterprise in which the state owns directly less than half of the capital is treated as ''private'', these estimates are in a sense upward biased (see below).

35. In 1948, some 70 per cent of GDP was produced by the private sector (Blazyca and Dabrowski, 1995).

36. Like in western European countries, these figures likely overstate the extent of ''creative destruction'' since some of the deaths and births are fictitious, either because the firm never really operated or due to tax and other incentives encouraging pseudo-creations (*i.e.*, winding up a business to re-start it under a new logo).

37. The mid-1980s are used as a benchmark because 1989 was in many ways no longer representative of the pre-transition regime: fixed investment had already collapsed to 16 per cent of GDP, while measured inventory accumulation had risen to a staggering 22 per cent. In the 1970s, fixed investment was higher, averaging 29 per cent of net material product.

38. In 1990-94, gross fixed capital formation averaged 20½ per cent of GDP in the OECD.

39. Owing to the valuation problems entailed by multiple exchange rate systems and to the distortions associated with administrative pricing, the estimates for 1989 should be interpreted with caution.

40. The admittedly crude typology used here distinguishes product groups as follows:
    – natural resource intensive: animal and vegetable products, fats and oils, processed foods, mineral products, leather products, wood pulp products, precious metals and base metal products;
    – skilled labour and capital/technology intensive: chemicals, plastics, mechanical and electrical machinery, transport equipment, optical products and arms;
    – low-skilled labour intensive: wood products, textile products, footwear, stone products, miscellaneous manufactured products and art.

41. Although this conclusion does carry over when looking at a two digit SITC sectoral decomposition, it may not at finer levels of disaggregation and should therefore be treated with more than the customary grain of salt.

42. Given the gap in per capita income levels, however, one would not expect full convergence in the short or medium run. Specifically, non-tradables are likely to remain cheaper in Poland for some time.

43. Privatisation in agriculture is dealt with in Annex I.

44. The total number of enterprises shown in Table 8 varies from year to year owing to closures and splits.

45. See in particular the studies conducted by the Gdansk Institute for Market Economics.

46. This procedure is also expected to reduce privatisation costs, to around 1-1½ per cent of the starting price (compared with 2½ per cent for the cheapest capital privatisation operation in 1995).

47. Key indicators for the Warsaw Stock Exchange are shown in Annex VI, Table A10. The market value typically exceeds the book value for the listed companies (but the reverse may hold for some SOEs). It should also be borne in mind that a significant portion of the shares of the listed companies is held by the state.

48. Long-lived large state holdings also exist in western Europe (*e.g.*, the Italian state holding IRI, set up in 1933).

49. As stressed by Boycko *et al.* (1996) in a slightly different context, the political costs of straight subsidies is higher than that of forgone SOE profits.

50. The previous *Survey* analyses the evolution of the banking sector from the late 1980s to 1994 in more detail.

51. At the end of 1995, the share of loans of sub-standard quality or less amounted to 30 per cent in the Czech Republic (OECD, 1996*b*) and 38 per cent in Slovakia (OECD, 1996*c*). Although these numbers may not be fully comparable, they do suggest that Poland was in a relatively favourable position.

52. Since inflation was declining, the increase in the profitability ratios shown in Table 11 understates the improvement.

53. Helping out a distressed incumbent has been *de facto* the price for entry borne by foreign banks. A similar rule seems to apply in the insurance sector.

54. The State reimburses PKO BP what it owes on account of the commitments it took on in the past in this area, but sometimes with delay.

55. Clients recovered a portion of their deposits thanks to the new Banking Guarantee Fund (which covers 100 per cent of deposits up to Ecu 1 000 and 90 per cent between Ecu 1 000 and Ecu 3 000).

56. For the mentioned seven banks, those bonds are to be serviced by the Bank Restructuring Fund, but for the specialised banks incorporated *ex post* into the programme the interest payments are borne by the state budget.

57. These ten banks accounted for about three fourths of the total debts covered by the scheme.

58. See, *e.g.*, Barbone *et al.* (1996) for econometric evidence of adjustment in 1990-93 based on two large samples of enterprises, or Belka *et al.* (1995) for evidence based on a survey of 200 enterprises at the end of 1993. An earlier seminal study, looking at 75 state-owned manufacturing firms in 1989-92 and supporting this view, is Pinto *et al.* (1993).

59. New challenges await the enterprise, however, including potential competition from low-wage Ukrainian and Russian shipyards, as they shift from military into civilian production.

60. A new company, reportedly taking over half of the employees, was set up for one year in order to complete the work in progress. The longer-run future of the shipyard is still under discussion.

61. Part of the reduction of employment took place through the privatisation of some of the mines' surface services.

62. Nowak *et al.* (1994) note that regional disparities as measured by the coefficient of variation of GDP per capita across voivodships did not change significantly between 1986 and 1992. As of mid-1996, no regional GDP data were available for subsequent years.

63. ''There are in a way two Polands between the rivers of Oder and Bug. The first one, which is modern, enlightened, educated and enterprising, is already the object of genuine interest of Europe and the world. Alongside it, there is another Poland, a land of poverty, degrading unemployment, functional illiteracy, civilisational underdevelopment, a deteriorating start for young people, underpaid teachers and doctors, poor culture and neglected science'' (excerpt of President Kwasniewski's inaugural address to Parliament on December 23, 1995).

64. Regressing the percentage of respondents perceiving an improvement G over the level of industrial production Q (base 100 = 1990), and the lagged rate of registered unemployment U (in per cent) from 1990 to mid-1996 produces (using ordinary least squares and introducing the lagged dependent variable to control for auto-correlation):

$$G = -7.3 + 0.4\,G_{-1} + 0.3Q - 0.7U_{-1}$$
$$(1.1)\quad (2.2)\qquad (3.7)\quad (2.0)$$

where the absolute values of the t statistics are in parentheses and the adjusted R square = 0.69.

65. The choice of 1987 as a base rests on the view that it is the latest year that can be considered representative of former normality.

66. Technically, it is necessary to select a social utility function. Some put a lot of weight on inequality, others none.

67. These indicators miss several dimensions of inequality, such as nomenklatura privileges and unreported incomes. The sign of the resulting net bias is *a priori* ambiguous.

68. The analysis below extends through 1995 but the early results for 1996 presented by Panek *et al.* (1996) suggest that poverty overall continued to recede in 1996.

69. The same phenomenon was noted in Hungary (OECD, 1995*d*).

70. The homeless are not covered by household budget surveys (nor are households of foreigners).

71. Caution is called for in cross-country comparisons, as national definitions sometimes differ significantly, as might the associated biases.

72. The impact of education may be overstated by those numbers in so far as incentives to find a job quickly may be weaker for the younger and less educated.

73. Those figures should be taken with a grain of salt, as it can be difficult to disentangle quits from lay-offs: ''mutually agreed'' separations may in some cases conceal actual lay-offs.

74. International comparisons are only indicative, especially when registration and LFS data are mixed.

75. That is also true in other transition economies, see OECD (1995*c*). Registration data are used in this section because the LFS data set is too small to allow for sufficient geographical disaggregation.

76. Paradoxically, cross-border mobility may aggravate skill shortages in Poland: for instance, skilled welders are reportedly hard to find in some areas because many of them work in Germany.

77. Participation in most ALP schemes qualifies participants for a new benefit period.

78. Those figures correspond to health care expenses *lato sensu, i.e.,* including hygiene (which in 1993-95 amounted to about half of this category).

79. In the first half of 1996, this rule translated into 33 per cent of the current wage. From September 1996, the minimum pension is indexed on the CPI.

80. The rules governing farmers' pensions differ significantly from the ones described hereabove.

81. It should also be administered efficiently and financed by an appropriate type of taxes, but those aspects are not dealt with below.

82. A more precise way to assess effectiveness would be to estimate how many of the poor (before transfers) are lifted out of poverty thanks to the transfers, or how much of the poverty gap the transfers allow to close. The World Bank (1995) carried out such an analysis for 1993 (using the minimum pension as the poverty line) and concluded that targetting was fairly successful. One of the leakages to the non-poor underlined by the World Bank pertained to family allowances but this has been reduced since with the introduction of means-testing.

83. It could be argued, though, that it is better to rotate people in and out of employment rather than having the outsiders become (very) long-term unemployed.

84. The relative price of household rents and utilities has increased since 1993, the year on which Freund and Wallich base their analysis, but not so much as to render the latter obsolete.

85. These are the numbers published by the Central Statistical Office which, however, understate the level of infant mortality as measured in accordance with the standards of the World Health Organisation.

86. As Perraudin and Pujol (1994) argue, the foreseeable aggravation of the pension burden is less dramatic, at least over the next two decades, if a trend decline in unemployment is factored in; but, as they concede, taking into account unemployment would also increase current dependency ratios.

87. The Solidarity trade union also formulated a plan, closer in spirit to that of the Ministry of Finance.

88. An April 1996 poll showed that about 2½ million persons (mostly private entrepreneurs) already had life insurance policies subscribed with one of the 14 institutions offering such products in Poland.

89. In an effort to push through the needed reforms, the government in July 1996 designated the Minister of Labour and Social Policy as plenipotentiary for social security reform *lato sensu* (including health).

90. *Package 2000* was proposed in January 1996 by Deputy Premier and Minister of Finance Kolodko (text published in *Rzeczpospolita* on January 31). The Council of Ministers endorsed it with minor amendments. A set of medium-term macroeconomic scenarios prepared by the Central Planning Office was also adopted by the government, but those are projections rather than targets.

91. Measurement problems are also rife, complicating the assessment even for EU members, as illustrated by the difficulties encountered in this context with the harmonisation of national statistics.

92. GDP per capita in the 15 EU countries comes very close to that in the OECD area. The same qualitative conclusions would thus hold if the latter had been used as the comparator. The comparisons with individual EU countries below should be treated with all the more caution as it is envisaged in some of them to incorporate part of the hidden economy into the national accounts (which would increase the measured income gap with Poland).

93. In absolute terms, Poland was the second biggest economy in transition in Central and Eastern Europe after Russia, larger than Hungary, the Czech Republic and Slovakia combined, and about the size of Finland.

94. In the mid-1950s, Poland's PPP per capita GDP well exceeded that of Spain (Balassa and Bertrand, 1970).

95. The increase in relative income observed when switching from market to PPP exchange rates is larger when Poland is compared with countries enjoying a higher standard of living, since the discrepancy between the two types of exchange rates typically falls as income per capita rises.

96. Sachs and Warner (1996) in such an exercise even argue that Poland might never reach 75 per cent of EU per capita GDP.

97. Relative income per capita levels valued at market exchange rates on the eve of their accession to the European Community were one fourth for Portugal and one half for Spain and Greece.

98. Cross-country experience is consistent with the proposition that openness is a necessary ingredient of the catch-up process (see, *e.g.*, Sachs and Warner, 1995 and Frankel and Romer, 1996).

99. For specifics, see Commission of the European Communities (1995).

100. In this paragraph, only convertible currency trade is taken into account, which biases 1990 magnitudes downwards by about one fourth.

101. For details, see Foreign Trade Research Institute (1995*b*).

102. Tariff binding conditions any increase in the rates on appropriate safeguard proceedings or compensation payments to foreign exporters.

103. For motor vehicles, tariffs are reduced more slowly, and scheduled to disappear only by end-2001.

104. As reported by the Polish Agency for Foreign Investment, and excluding investments of less than $1 million.

105. Until 1990, the stock of foreign capital in Poland was very limited.

106. Surveys suggest, however, that one in five joint ventures registered in Poland never operated or ceased to do so.

107. Brownfield projects involve the take-over of a site including land and buildings, rather than of a going concern.

108. The original law dates back to the time when the borders of the Second Republic were threatened, but has been amended numerous times since.

109. ADRs (GDRs) are typically issued by a US (foreign) depository bank in an amount corresponding to the value of shares held by a fiduciary in the issuer's country, and are tradable in the United States (on the international market).

110. This is a narrow measure of environmental investments, excluding the purchase of new machinery that happens to pollute less than the existing one. For instance, the installation of a filter in a power generating plant would be included, but not that of a more environmentally friendly boiler.

111. Mines exploit a legal loophole, invoking a provision to the effect that fines can be suspended if the source of non-compliance with the environmental norms is removed within five years, which they claim they will do.

112. Although this directive will not be binding before 2006, the need for Polish legislation to approximate EU standards makes it an immediately relevant constraint.

113. Methane and biomass would be two additional ones.

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Annex I

Agriculture

Poland stands out as one of the OECD countries where agriculture is large, inefficient and relatively inert. Agriculture represents one quarter of total employment and only 6½ per cent of GDP, average apparent labour productivity increased by only 10 per cent between 1989 and 1995 (compared to over 25 per cent in the economy as a whole), and most structural indicators show only modest changes during the first half of the 1990s (Table A1). This annex outlines the agricultural legacy at the end of the 1980s, offers an overview of developments since, noting that in some respects more adjustment is underway than meets the eye, and concludes with a few speculations about the future.[1]

Legacies

Three types of farms existed in the 1980s. Small-scale private farming, which has always predominated, represented 76 per cent of land and 84 per cent of output in 1989. There were some 2.1 million private farms (exceeding one hectare), with an average size of about 6 hectares. However, one quarter of private farmers also worked outside agriculture. State-owned farms had been established after the second World War, mainly in the North and in the West. In the mid-1980s, there were some 1 300 such farms, with an average size of 2 700 hectares, typically specialised in grain production but often also engaged in food processing and agricultural services. Co-operative farming under socialism was organised along the same lines as state farming. In the mid-1980s, there were some 2 300 co-operative farms with an average size of 300 hectares. The emphasis on industrial development meant the relative neglect of rural areas, and explains their often poor infrastructure, be it for roads, water supply, sewage or telephones.

The transition so far

The onset of transition radically changed the operating environment of farms. Specifically, the structure of taxes and subsidies underwent very large shifts, and agriculture suffered a major negative inter-sectoral terms-of-trade shock (following a positive

Table A1. **Agricultural indicators**

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Structures										
Share of rural population (per cent)	39.5	39.1	38.8	38.4	38.2	38.0	38.3	38.2	38.1	38.2
Agriculture:										
Share in civilian employment (per cent)	30.0	29.4	28.8	27.8	28.0	26.0	26.2	26.1	26.6	26.5
Share in GDP (per cent)	12.8	11.0	12.1	11.8	7.1	6.2	6.7	6.6	6.2	6.6
Number of pensioned farmers (thousands)	1 118	1 199	1 283	1 356	1 506	1 790	2 000	2 027	2 046	2 049
Total agricultural land (thousands ha)	18 804	18 791	18 742	18 727	18 720	18 674	18 664	18 642	18 648	18 622
Public sector (per cent)	18.8	18.7	18.8	19.7	20.0	20.0	19.8	16.4	12.8	10.2
of which: state farms (per cent)	. .	. .	. .	18.7	18.6	18.6	17.7	13.9	10.0	7.3
Share of state farms in total value of agricultural output (per cent)	. .	. .	16.9	16.2	17.9	15.5	11.6	8.3	5.6	4.5
Number of farms										
State farms	1 271	1 240	1 226	959	1 112	1 409	. .	. .	. .	. .
Co-operative farms	1 833	1 767	1 760	1 786	1 783	1 721	2 172	2 149	2 093	2 061
Private farms (thousands)	2 260	2 235	2 168	2 143	2 138	2 138	2 144	2 149	2 030	2 048
Average farm size (ha)										
State farms	2 636	2 696	2 731	3 490	2 924	2 305	1 786	. .	. .	. .
Private farms	6.0	6.1	6.2	6.3	6.3	6.3	6.3	6.2	6.7	6.7
Production										
Yearly per cent change										
Total final output	6.3	–4.6	2.8	1.8	–5.5	–1.6	–10.7	8.0	–10.8	16.3
Crops (gross)	11.4	–7.8	1.5	5.9	–4.9	–4.6	–24.8	47.7	–23.8	27.6
Animal products (gross)	3.5	–2.7	3.5	–0.5	–5.8	–0.1	–4.0	–11.5	–0.4	9.8
Level (in thousands of tonnes)										
Wheat	7 502	7 942	7 582	8 462	9 026	9 270	7 368	8 243	7 658	8 668
Rye	7 074	6 817	5 501	6 216	6 044	5 900	3 981	4 992	5 300	6 288
Coarse grains[1]	10 460	11 301	11 421	12 280	12 944	12 641	8 613	10 182	8 805	10 949
Potatoes	39 037	36 252	34 707	34 390	36 313	29 038	23 388	36 270	23 058	24 891
Sugarbeet	14 217	13 989	14 069	14 374	16 721	11 412	11 052	15 621	11 676	13 309
Rapeseed	1 298	1 186	1 199	1 586	1 206	1 043	758	594	756	1 377
Cow milk	15 778	15 531	15 632	16 404	15 832	14 443	13 153	12 639	12 222	11 642
Beef (carcass weight)	748	750	727	675	793	651	492	408	373	373
Pig meat	1 720	1 702	1 784	1 819	1 841	2 011	2 069	1 975	1 736	2 008

Table A1. **Agricultural indicators** *(cont.)*

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Prices										
Producer subsidy equivalent (per cent)	43	32	28	9	–20	6	14	16	21	. .
Inter-sectoral terms of trade (output/input prices)										
Yearly per cent change	–2.5	0.7	2.8	29.5	–57.9	–27.3	13.8	–4.2	6.0	1.6
Level, 1986 = 100	100.0	100.7	103.5	134.1	56.4	41.0	46.7	44.7	47.4	48.2
Performance										
Yields (100 kg/ha)										
Wheat	37	37	35	39	40	38	31	33	32	36
Rye	26	26	24	27	26	26	20	23	22	26
Coarse grains[1]	30	31	29	31	33	32	22	27	24	29
All agricultural and food products[2]										
Share in total exports (per cent)	9.1	10.5	9.8	11.4	11.1	7.9	13.5	11.1	11.6	9.3
Share in total imports (per cent)	11.3	11.7	13.1	12.5	7.0	4.4	11.3	11.2	10.3	9.6
Trade balance ($ millions)	–167	–30	–298	255	915	465	–19	–536	–224	–426

1. All grains less wheat and rye.
2. Customs basis, excluding unrecorded exports and imports.

Source: Central Statistical Office, OECD (1995), OECD (1996).

shock in the second half of the 1980s, however). Aggregate production dropped by about 8 per cent between 1989 and 1995 (both propitious harvest years), with plant output naturally more volatile in the intervening years than animal output.

Measured employment dropped by some 16 per cent, but in fact almost half a million farmers lost their job outside agriculture. This decline in double-jobbing means that effective employment in agriculture declined less. At the same time, a remarkable generational switch occurred as many young farmers took over the farm from their parents: in the late 1980s, more than half of the farmers were over 60; by the mid-1990s, half of them were younger than 44. This development was facilitated by the easier access to pensions granted to elderly farmers and was spurred by the lack of job opportunities outside farming for the young. In that sense too, effective labour resources in agriculture dropped less.

Farm size increased by only 10 per cent overall, and by 1995, almost half of agricultural land still belonged to farms of less than 10 hectares (compared to 15 per cent in the EU a few years earlier).[2] However, the number of large private farms (exceeding 15 hectares) increased by 19 per cent, suggesting that some regroupement and rationalisation of land use is taking place.

Privatisation of the state-owned farms is carried out by the Agricultural Privatisation Agency (APA). By early 1996, the APA had taken over practically all the land, but only sold 7 per cent of it (versus 70 per cent of non-land assets). Over 76 per cent of the land had been leased out, usually for 10 years, with a pre-emptive right for the lessee to purchase at expiration. This allows farmers to invest more in machinery and working capital.

Whereas financial support from the state came mainly in the form of price subsidies in the 1980s, it now chiefly comes in the form of the subsidy to the Social Insurance Fund for farmers, which is almost completely funded by the budget. Other forms of support include the exemption from VAT on agricultural inputs, a very liberal income tax regime, low land taxes, and interest rate subsidies. The Agency for Restructuring and Modernisation for instance extends 15 year 5¾ per cent investment loans to young farmers.[3] In addition, the state-funded Agricultural Market Agency intervenes to stabilise prices, mainly for grains, milk and meat. Overall, the producer subsidy equivalent (*i.e.*, the ratio of support to gross farm revenue), which had collapsed from 43 per cent in 1986 to minus 20 per cent in 1990, subsequently recovered, principally as a result of successive increases in import tariffs. In 1994-95, it hovered in the neighbourhood of 20 per cent (OECD, 1996). It thus remained substantially lower than in most other OECD countries.

Looking ahead

The share of agricultural employment is bound to shrink over time (see Kwiecinski, 1996 and Orlowski, 1996).[4] The pace of adjustment, however, will be conditioned by the

rate of job creation outside agriculture, including in rural areas. There is clearly scope for very large productivity gains over the medium run, through the rationalisation of resource use, further institution building (*e.g.*, by the development of commodity exchanges and futures markets), and the modernisation of the upstream and downstream sectors.

Protectionist measures have become more numerous and far-reaching over the last few years, leading to higher domestic prices and implying significant transfers from consumers to producers (in addition to taxpayer support). In this respect, Poland has been pursuing policies analogous to those encapsulated in the EU's Common Agricultural Policy. However, convergence of policies in this instance may make integration with the EU more difficult in the future, as it tends to slow down the needed structural adjustments in agriculture. At the same time, export subsidisation on the part of richer OECD countries admittedly encourages the maintenance of trade barriers.

Notes

1. For an in-depth assessment, see OECD (1995).
2. There are large variations within the EU, though: the average farm size in Greece is smaller than in Poland.
3. In 1995, the Agency received Zl 151 million for investment loan subsidisation and Zl 287 million for the subsidisation of working capital loans.
4. This share dropped from 30 per cent in the early 1960s to less than 10 per cent now in Spain. In Ireland, it dropped from 26 to 13 per cent between the early 1970s and the early 1990s.

Annex II

Unrecorded exports

The external trade data appearing in the balance of payments published by the National Bank of Poland originate with the banking system and are payments-based (see Table A9 in Annex VI). They differ significantly from the customs-based statistics compiled by the Central Statistical Office, with most of the discrepancy pertaining to imports. In 1995, the second source pointed to a trade deficit of $6.2 billion whereas according to the first source the deficit amounted to only $1.8 billion. In both cases, a large portion of actual trade flows is not captured, especially on the export side. Taking into account those unrecorded transactions greatly changes the physionomy of the balance of payments and the diagnosis of Poland's external position.

Notwithstanding ongoing tendential real appreciation of the zloty, prices for many tradable goods and services have remained much lower in Poland than in Germany over the past few years. For a number of items, prices are typically several times as expensive in Germany as in Poland (Foreign Trade Research Institute, 1995). Many German residents have taken advantage of those enormous price differentials, crossing the border on brief and frequent shopping trips to purchase food, petroleum, clothing, and other items.[1] Whole shopping centres have sprung up catering to the needs of those non-resident customers, and retail sales in some of the areas along the western border have boomed. Anecdotal evidence on unrecorded imports also abounds, as an increasing number of Polish residents travel to Germany to buy such goods as consumer electronics, chocolates and beer, which have become less expensive there than in Poland.[2] Unrecorded trade with the East is substantial as well, as witnessed by the numerous individual traders from Belarus, Ukraine and Russia to be seen on outdoor markets in Warsaw, Lodz and other Polish cities (Box 1). Casual empiricism suggests that unrecorded imports from the East progressively lost in importance, partly owing to poor product quality, whereas unrecorded exports have been growing rapidly. Westwards unrecorded trade mainly pertains to retail trade, whereas eastwards wholesale operations dominate.

By their very nature, the corresponding external trade flows are difficult to measure.[3] They were too conspicuous, however, to be ignored by the statistical authorities. Surveys were therefore undertaken in 1993 at selected border crossings in an attempt to quantify

Box 1. **Poland's fifth largest exporter**

Every morning, hordes of small traders from all over eastern Europe and Asia converge on a somewhat grim sports stadium in Warsaw to buy and sell a dazzling variety of consumer goods in the ''Europa Bazaar''. Occasionally braving bandit attacks by compatriots en route, individuals from the former Soviet Union arrive in special buses to purchase items that are pricey or scarce at home. Although Warsaw residents visit the stadium as well, two thirds of sales are exports, amounting to an estimated $350 million in 1995.[4] If the bazaar were a company rather than a loose collection of hawkers and stallholders, it would be Poland's fifth largest exporter.

this type of flows (Central Statistical Office, 1996). The coverage of these surveys was subsequently increased, as expertise built up (by 1995, Poland was even extending statistical technical assistance in this field to some of its northern and eastern neighbours). Nevertheless, the survey information remains rather tentative, not least because of the reliance on the voluntary co-operation of cross-border shoppers.

The surveys confirmed that unrecorded exports represent a large chunk of total exports (Table A2). In 1995, the amount of purchases of goods in Poland by visitors from

Table A2. **Unrecorded exports indicators**

	1994	1995
Number of border crossings (millions)		
Polish citizens going abroad	34.3	36.4
Foreigners entering Poland	74.3	82.2
Goods and services purchased in Poland by non-residents according to the survey at border crossings (in $ millions)	2 116	3 740
of which (in per cent of total):		
Motor fuels	11.0	9.8
Clothing, footwear	20.4	22.5
Food	24.2	22.7
Net purchases of foreign currency by banks (in $ millions)	3 211	7 754
Memorandum item:		
Recorded exports of goods and non-factor services (NBP, in $ millions)	19 050	26 068

Source: Central Statistical Office, National Bank of Poland.

Belarus estimated on the basis of the survey was 31 per cent larger than total recorded goods exports from Poland to Belarus. For Slovakia, the Czech Republic, Lithuania and Ukraine such purchases ranged between 23 and 31 per cent of total recorded exports. For Germany, the ratio stood at 16 per cent. The total amount of purchases of goods as estimated in the survey was equivalent to 14 per cent of total recorded goods exports, based on customs data (and 5 per cent of total retail sales). Purchases of services (mostly catering and lodging) were also substantial, amounting to about one sixth of goods purchases. The total amount of unrecorded exports of goods and services as estimated based on the survey amounted to $3.7 billion in 1995.

An alternative way to gauge the magnitude of unrecorded exports is to use banking data, which are not affected by the likely lack of candidness of the aforementioned survey respondents. A large portion of unrecorded exports involves purchases of zlotys by non-residents at kantors (foreign exchange bureaus). The bulk of the proceeds is typically sold to banks and as such was until 1995 included in the balance of payments in the short-term capital inflows line. Movements on individuals' bank accounts denominated in foreign exchange, which are recorded as private transfers in the balance of payments, also partly reflect cross-border trade transactions. However, some of the latter are not reflected in domestic banking statistics. Vice-versa, some of the flows traced by banks on those accounts are not related to cross-border trade transactions. Indeed, part of the latter do not involve any currency exchange (*e.g.*, in the case of barter, or when traders carry working balances in cash, or when only accounts abroad are debited and credited). Inflows and outflows of foreign exchange also reflect portfolio shifts. In 1995, the expected dollar return on zlotys was attractive enough to prompt substantial de-dollarisation, some of which showed up in the private transfers and short-term capital flow entries of the balance of payments. Taking into account those caveats, as well as available guesstimates on unrecorded imports (in 1995, Polish residents may have spent about $1 billion in Germany,[5] while total unrecorded imports may have reached $2 billion), unrecorded exports may have totalled $6-7 billion gross and $4-5 billion net.

The official trade and current account balances show rising deficits in 1994-95 (Table A9 in Annex VI). Although uncertainty remains about the exact size of unrecorded exports, it seems clear that even on conservative assumptions, they far exceed the trade and current account deficits appearing in the NBP balance of payments. Consequently, the actual trade and current account balances have remained in substantial surplus. Even so, the implications for the assessment of the competitiveness of the Polish economy are not straightforward. Indeed, price differentials are orders of magnitude larger for the items subject to unrecorded trade than for the ones captured in the official balance of payments. Therefore, the volume of cross-border purchases would presumably be much less sensitive to real exchange rate movements than the volume of recorded imports and exports, a dichotomy reminiscent of the ''Dutch disease'' problem.

In January 1996, the NBP changed the presentation of the balance of payments, switching to the format prescribed by the fifth edition of the IMF *Balance of Payments*

Manual. In the process, the ‘‘Purchases/sales of foreign currencies’’ line was shifted from the former capital account into the current account, and re-labelled ‘‘Unclassified transactions’’. As noted, this measure is an imperfect but nevertheless useful proxy for unrecorded net exports. In the first quarter of 1996, these operations resulted in a surplus of $1.8 billion, more than offsetting the $1.5 billion deficit on recorded trade and the $0.1 billion deficit on non-factor services.

Notes

1. A significant share of those purchases pertains to categories classified as ‘‘sensitive’’ by the EU. Others are quite exotic, such as the very popular (with German buyers) garden gnomes.

2. A June 1995 survey of 600 Poles crossing the German border westwards showed that on average, they spent some DM 250 in Germany (Karwowski, 1996).

3. For this reason, they tend to be overlooked in western European countries as well.

4. According to a recent survey by the Gdansk Institute for Market Economics, the results of which were reported in *New Europe*, June 30-July 6, 1996.

5. Rough estimate provided orally by a representative of the Central Planning Office.

Annex III

Hidden employment and unemployment

The bulk of the analyses and comments on labour market developments, in Poland as in other countries, are based on employment and unemployment as officially registered. While this can be justified by the timeliness and precision of this type of data, it may lead to a misrepresentation of actual levels and trends. Indeed, a substantial number of persons registered as unemployed or excluded from the labour force statistics have one, or even several, jobs. At the same time, some truly unemployed persons are not registered as such with the labour offices. This annex presents some estimates of hidden employment and unemployment.[1]

Hidden employment is a long-standing feature of the Polish economy. It was widely noted, if not recorded, prior to the transition. The main underlying motivation changed with liberalisation, from a desire to circumvent prohibitions to a wish to avoid taxes, although both considerations have always played some role. Surveys suggest that the scope of hidden employment is too large to be ignored. One nation-wide survey of a bit over 1 000 people suggested that in 1994, almost 30 per cent of the population of working age was engaged in some form of clandestine employment, with an average amount of about 8½ hours per week, and that unregistered income averaged about one seventh of total personal income (Grabowski and Jedrzejowicz, 1995). Almost half of the registered unemployed in the sample had an unrecorded job, and this group spent about twice as much time as the average respondent moonlighting; the share of income from illegal work for the unemployed exceeded 40 per cent of their total income. The same survey indicated that the average remuneration for clandestine work was over twice the rate of analogous legal employment, reflecting the heavy burden of social security contributions and personal income tax falling on registered jobs. Another survey, covering some 100 private non-agricultural firms, indicated that in 1994, four out of five had over 5 per cent of moonlighters amongst their employees. Overall, moonlighters were estimated to constitute 12 to 15 per cent of total employment in private, non-agricultural companies (Grabowski and Jedrzejowicz, 1995).

While suggestive, the results from such small-scale surveys are not statistically robust. GUS has undertaken a more ambitious and more reliable set of surveys in this area. The latest one, conducted in 1995, covered over 11 000 households (Kalaska and Witkowski, 1996). It showed that 2.2 million people – *i.e.*, 10 per cent of the population

of working age and 13 per cent of the labour force – were employed without being recorded as such. For 960 000 persons, hidden employment was the main source of income. Hidden employment concerned men more than women, urban more than rural dwellers, and poorly qualified more than highly educated persons. The average income from informal work amounted to Zl 172 per month (*i.e.*, around $70). The largest contingents of informal workers were found in agriculture and construction. Other activities with significant hidden employment included repairs and renovation work, trade, tailoring, transportation, private tutorials, medical and nursing services, translations, legal and accounting advice, and some small-scale production. The primary motivation for moonlighting was the need to supplement family income. Second on the list was the lack of a legal job, and third, high income taxes. Employers mentioned high social insurance contributions as their main incentive.

A large proportion of the informal workers were registered as unemployed. This is the main reason for the big discrepancy between the administrative and the labour force survey (LFS) measures of unemployment:[2] as of August 1995, the former stood at 15.2 per cent of the labour force, while the latter stood at 12.9 per cent. Almost one third of the registered unemployed did not meet the LFS unemployment criteria: some performed odd jobs without declaring it to the labour office, others had found a job but had not yet been erased from the register.[3] At the same time, one fourth of the persons recognised as unemployed by the LFS were not registered with labour offices. Many of those individuals were no longer eligible for unemployment benefits and had given up on the hope of obtaining a job via the labour office. In addition, some 280 000 persons – or 1½ per cent of the labour force – could be considered as discouraged workers, as they were no longer actively seeking work, not expecting to find any, even though they wished to work.

One specificity of the Polish labour market is the extent of disguised unemployment in agriculture. A large number of individuals, representing as much as 3-4 per cent of the total labour force, are retained by farms without pay.[4] These workers are typically counted as employed in the LFS, even though some of them are registered as unemployed with labour offices.

The above estimates pertain to 1995. Comparing survey results over time suggests some tendential increase in the size of hidden employment but also in the number of discouraged workers, at least until 1994.

Notes

1. Largely abstracted from in this annex is the problem of under-employment (labour hoarding), which was notorious in the late 1980s and has most likely declined since, although not disappeared altogether. Also, vacancy statistics are subject to some of the caveats discussed here for unemployment data.

2. The LFS utilises the definition of unemployment recommended by the International Labour Organisation (ILO). LFS statistics count anyone who worked for at least one hour during the surveyed week as employed; this concept differs from that of registered unemployment in so far as it relies on the ILO's criteria of not being employed, actively looking for work and being willing to accept a job offer, rather than on an administrative criterion.

3. A registered unemployed retains the full right to unemployment benefits when working as long as the associated income does not exceed 50 per cent of the minimum wage (in which case the job in question is unlikely to be this person's main source of income).

4. This phenomenon should be viewed as an informal component of the social safety net more than as labour hoarding in the traditional sense.

Annex IV

Mass privatisation

Mass privatisation as pursued in a number of transition countries has had several objectives, of variable relative importance. One has been to redistribute wealth from the state to households, several decades after confiscatory nationalisation, often with the hope that such restitution would bolster political support for market-oriented reforms. Mass privatisation was often perceived as more equitable than other forms of ownership transfer insofar as by granting ownership rights to the population, it would prevent insiders, notably the nomenklatura, and outsiders who had not suffered under central planning, such as foreign investors, from capturing all the valuable assets. Another objective, particularly prominent in the Czech Republic and Russia, has been to speed up the divestiture of the state, which was expected to minimise the losses associated with temporary residual state ownership, and to ensure early on the irreversibility of transition. A third objective was to accelerate the development of a domestic equity market. Mass privatisation was perceived as a way to provide a substantial supply of securities and to offer learning-by-doing in the elementary rules of capital markets to a large portion of the population.

The first governmental version of the Polish mass privatisation programme (MPP) dates back to mid-1991. After long debates and numerous amendments, the corresponding legislation was passed by the Sejm in April 1993, in the form of a National Investment Fund Law. The government that took office a few months later showed a certain unwillingness to move ahead with privatisation, which further delayed the implementation of the MPP: it was only in November 1994 that the Council of Ministers took the decisions necessary to start concrete arrangements. During this lengthy gestation period under several governments the concept of the mass privatisation programme underwent changes, as did the economic environment and the state of the enterprises concerned by the programme, affecting the scope and chances of success of the current scheme.

The MPP currently being carried out gives a key role to 15 National Investment Funds (NIFs), which are the main owners of the enterprises included in the programme, and as such are expected to actively help them improve their performance, obtain financing, and establish contacts with potential customers, among other things. The NIFs were set up by the state and, except for one, are run by management groups including domestic and foreign participants – mainly banks and consulting firms – chosen for a

period of 10 years in an international tender. The fund managers are to receive an annual remuneration which has been negotiated individually for each group, and totals $42 million for the 15 NIFs per year. Each NIF has a supervisory board controlling its activities. The functioning of management firms is initially financed by loans from the European Bank for Reconstruction and Development and the World Bank, guaranteed by the Polish government.

The process of selecting enterprises for the MPP began in 1993, but the last tranche of enterprises was incorporated in the programme only in September 1995. Participation was voluntary albeit subject to government approval. Altogether, 512 medium-sized and mainly industrial companies were included, representing about 8 per cent of the sales of medium and large-sized Polish enterprises and one tenth of the book value of state enterprises according to 1994 financial data (Table A3). Although it had originally been intended that the enterprises participating in the MPP would be in good financial shape, this does not turn out to be the case: in 1994, 31 per cent of the 512 companies recorded losses. Indeed, the situation of some of them deteriorated over time, as privatisation and restructuring continued to be postponed. Moreover, some of the better performing enterprises were reluctant to join the programme, perceived as cutting them off from potential strategic foreign investors. Furthermore, the criteria for participating in the programme were gradually relaxed, at the request of weaker potential enrolees.

Each NIF holds shares in every company, with one NIF owning a strategic stake of 33 per cent and all the others holding a total of 27 per cent. The companies were allocated across NIFs in a lottery. Of the 60 per cent of shares going to the NIFs, 51 percentage points are converted into share certificates and the rest serves as a performance-related remuneration for the NIF managers. As a general rule, 15 per cent of the shares is reserved for the employees. The rest, in most cases 25 per cent of the shares,[1] remains with the State Treasury.

All 27.4 million adult Polish citizens are entitled to one so-called universal share certificate, which in due course is to be exchangeable into NIF shares (on current plans, one of each NIF). The distribution of the certificates started on 22 November 1995, and is to last 12 months. The certificates can be retrieved at the branches of the savings bank, PKO BP, against payment of a Zl 20 fee, intended to cover the costs of distributing certificates.[2] The demand for certificates surpassed the authorities' expectations. By end-September 1996, 18.9 million people (69 per cent of the eligible population) had taken up their certificates. Certificates are freely transferable. A secondary market rapidly emerged, at PKO BP branches, at the counters of some other banks and currency exchange offices, and on a private basis. Quotation of the certificates on the Warsaw Stock Exchange (WSE) started in July 1996, at Zl 104 a piece. The intrinsic value of the certificates will remain uncertain until the deadline for their collection lapses, as it depends on the final number of certificates handed out. Estimates based on 1994 values suggest that if all eligible citizens took delivery of their certificate, the book value of assets per certificate would equal about Zl 136.

Table A3. **Enterprises included in the MPP**

	1994 sales, profits and assets			
	Number of companies		Sales (Zl million)	
	MPP	Per cent in total[1]	MPP	Per cent in total[2]
Total	**512**	**3.3**	**12 816**	**8.1**
Metallurgy	8	11.9	465	5.0
Electro-engineering	150	7.5	3 284	15.8
Chemical	42	9.4	2 078	20.9
Mineral	43	8.0	845	21.4
Wood and paper processing	33	5.5	809	16.8
Light industry	67	5.2	1 439	23.9
Food	62	4.7	1 965	8.3
Construction	69	2.7	1 108	10.0
Transport	9	0.7	182	1.8
Commerce	16	0.3	400	0.7
Other branches of industry	13	4.6	241	17.1

Distribution of enterprises in the MPP

Profit before tax (in Zl million)	Per cent	Total assets (in Zl million)	Per cent	Sales (in Zl million)	Per cent
Less than –1	17	Less than 5	6	Less than 10	15
–1 to 0	14	5 to 10	19	10 to 15	18
0 to 1	26	10 to 20	31	15 to 25	23
1 to 2	12	20 to 30	17	25 to 50	27
2 to 5	19	30 to 50	13	50 to 100	12
5 and over	10	50 and over	12	100 and over	3
No information	2	No information	2	No information	2

1. Total defined as units employing more than 50 persons (in manufacturing, mining and quarrying) or over 20 persons (in the other sectors).
2. Total defined as units employing more than 5 persons.

Source: Ministry of Privatisation.

It is expected that over the next few years 3 to 5 companies from each NIF might be introduced on the WSE, significantly increasing the number of listed companies (which in mid-1996 stood at 62), and that another 10 companies from each NIF might see their shares traded over the counter. Shares of the NIFs themselves are likely to start being listed in early 1997.

It is still too early for a full assessment of the effectiveness of the MPP. However, it can be pointed out that several of the original objectives have not been met, not least owing to the failure to implement the programme early on. The quality of the pool of assets covered by the MPP likely suffered as a result, making the task of NIF managers

harder than it would otherwise have been. During the spring of 1996, disagreements already arose between some fund managers and supervisory boards, reflecting their differing expectations. Fund managers were perhaps not always prepared for the extensive restructuring that their enterprises now need, while supervisory boards may have had too optimistic a perception of the prospects of the enterprises.

The value of the assets thus transferred to the population is modest, meaning that the scope of the implied redistribution of wealth is limited. So is the political bonus in favour of reforms, as attested indirectly by the results of the February 1996 referendum on property rights. If implemented more swiftly, the MPP could have speeded up the overall privatisation process much more than it actually does. It would also have contributed more significantly to the pedagogy and emergence of capital markets, although it may still play a useful role in their development. Finally, the structure of the MPP does provide a mechanism for improving corporate governance in the enterprises subject to the programme. In particular, it offers the enterprises a strategic investor. It remains to be seen how effectively this device will operate.

Notes

1. In some cases, 15 per cent of the shares are distributed free of charge to farmers and fishermen who have been in contractual relationship with the enterprise.
2. A much higher fee, of 10 per cent of the average wage (or about Zl 80) had been envisaged earlier on but a more modest one was chosen in the end in order to facilitate the participation of the vast majority of interested citizens.

Annex V

Chronology of main economic events and policy measures

1994

January

Investment tax relief is introduced for economic entities with profits exceeding a certain percentage of sales and free of arrears on corporate taxes and social contributions, as well as for exporters.

The marginal personal income tax rates are raised from 20, 30 and 40 per cent to respectively 21, 33 and 45 per cent, and brackets (including for exemptions) are adjusted for wage inflation. Flat-rate income taxes are introduced for individuals operating small enterprises.

The mandatory registration threshold for the VAT is lowered and various service activities are brought into the VAT base.

Wages in the budgetary sphere are increased by 9 per cent.

February

On February 1, the Europe Agreement fully enters into force.

From February 1, reserve requirements are introduced on foreign exchange deposits (0.75 per cent for demand deposits and 0.50 per cent for term deposits).

A Tripartite Commission (including representatives of the government, employers and workers) is created as the forum for central collective bargaining.

Fixed-rate two and five year Treasury bonds are auctioned off for the first time.

A Law on copyrights is adopted, improving the protection of intellectual property rights.

March

Pensions are increased by 12.8 per cent.

On March 4, the Ministry of Finance initiates a conditional cancellation of tax arrears incurred between 1990 and 1993 under some already defunct laws.

On March 10, an agreement in principle is reached with foreign commercial bank creditors on a debt reduction and restructuring operation.

The tax on ‘‘excessive’’ wage increases (*popiwek*) lapses as of March 31.

April

On April 8, Poland applies for membership in the European Union.

On April 12, the President signs the 1994 budget (passed by Parliament on March 25) into law.

On April 21, the second stage of Poland’s debt reduction and restructuring agreement with the Paris Club comes into force.

May

On May 13, the NBP cuts the rediscount rate from 29 to 28 per cent, the refinance rate from 35 to 33 per cent, and the Lombard rate from 33 to 31 per cent.

June

Pensions are increased by 10.2 per cent.

Wages in the budgetary sphere are increased by 12.9 per cent.

A Law on public procurement is passed by the Sejm (subsequently amended in July 1995).

On June 21, a system of variable levies on the import of selected agricultural and food products is imposed.

On June 24, the government approves the 1994-97 economic programme *Strategy for Poland*.

August

The *popiwek* is replaced for the remainder of the year by a new set of regulations.

On August 5, the IMF grants Poland a 19-month and SDR 545 million stand-by arrangement.

On August 13, a law recapitalizing and reorganizing BGZ and the rural co-operative banks becomes effective.

September

On September 13, the monthly rate of devaluation of the zloty is cut from 1.6 to 1.5 per cent.

October

A Law on special economic zones is passed.

As of October 25, required reserves on foreign exchange deposits are increased to 1 per cent, and required reserves on zloty demand deposits are cut from 23 to 20 per cent.

On October 27, the London Club agreement on debt reduction and restructuring is finalised (after approval by the IMF, on October 12, of a related SDR 283.3 million purchase), cutting the net present value of the debt to commercial banks by 49.2 per cent.

November

On November 30, the monthly rate of devaluation of the zloty is cut from 1.5 to 1.4 per cent.

December

Pensions are increased by 10.3 per cent.

As of December 31, a new foreign exchange law comes into force.

1995

January

As of January 1, the zloty is redenominated with one new zloty equalling 10 000 old zlotys.

As of January 1, a Law on toll roads goes into force.

The average tariff on industrial goods is reduced from 11.8 to 9.3 per cent and the import surcharge from 6 to 5 per cent.

The existing system of wage norms is replaced by a consensual approach (enshrined in the December 16, 1994 law) under which negotiations between labour and management are guided by indicative norms set by the Tripartite Commission.

Wages in the budgetary sphere are increased by 10.4 per cent.

The state-owned Bank Przemyslowo-Handlowy of Cracow is privatised.

Poland signs an agreement with Russia to settle mutual debts with the former USSR (still to be implemented, however, as of mid-1996).

February

On February 16, the monthly rate of devaluation of the zloty is cut from 1.4 to 1.2 per cent.

The Law on the Banking Deposit Guarantee Fund comes into force on February 17, providing a bank-funded scheme of deposit insurance for all commercial banks.

On February 21, the NBP raises its Lombard, rediscount and refinance rates by 2 to 3 percentage points.

On February 28, SDR 225 million is repaid ahead of schedule to the IMF.

From February 28, the rate of required reserves on zloty term deposits is cut from 10 to 9 per cent.

March

Pensions are increased by 13.8 per cent.

A new coalition government is formed, headed by Prime Minister Oleksy.

On March 6, the NBP sets its bid and ask rates +2 and –2 per cent around its central exchange rate.

On March 7, the President signs the 1995 budget (passed by Parliament on December 30, 1994) into law.

April

In mid-April, Germany, Poland, Belarus and Russia agree on the construction of the E-20 high-speed rail link between Berlin, Warsaw, Minsk and Moscow, and of the A-2 super-highway.

May

Quantitative restrictions on agricultural imports are converted into tariffs in line with GATT Uruguay Round provisions.

On May 16, the exchange rate system is changed: restrictions on the interbank market are relaxed and the currency is allowed to fluctuate within a ±7 per cent band around a central rate which continues to be devalued at a monthly rate of 1.2 per cent.

On May 29, the NBP lowers the Lombard, rediscount and refinance rates by 4 percentage points.

June

From June 1, Poland accepts the obligations pertaining to current account convertibility spelled out in Article VIII, Sections 2, 3 and 4 of the IMF Articles of Agreement.

On June 1, the credit rating agency Moody's awards Poland an investment grade rating, opening the way for a successful eurobond issue, initially of $200 million but subsequently raised to $250 million.

On June 29, a Law on official statistics is passed, assigning forecasting responsibilities to the Central Statistical Office.

July

Wages in the budgetary sphere are increased by 17.3 per cent.

Poland becomes a member of the World Trade Organisation. The average tariff on industrial goods is reduced to 8.2 per cent, and the system of variable levies on the import of selected agricultural and food products introduced in June 1994 is abolished.

The 413 state owned enterprises involved in the mass privatisation programme are allocated to 15 national investment funds.

On July 17, Poland repays all its obligations to the IMF ahead of schedule. This abrogates all formal performance and review clauses set forth in the stand-by arrangement.

August

On August 20, the June 29, 1995 Law on bonds comes into force, making possible issuance of bonds by entities other than the Treasury.

September

An extra 101 firms are added to the mass privatisation programme.

On September 18, the NBP lowers the Lombard, rediscount and refinance rates by 2 percentage points.

October

Wages in the budgetary sphere are increased by 14.6 per cent.

A first special economic zone is inaugurated in Mielec.

The Korean conglomerate Daewoo establishes a joint venture with the Polish car manufacturer FSO, pledging to invest $1.2 billion by end-2001.

November

On November 19, Aleksander Kwasniewski is elected President.

The distribution of investment certificates in the context of the mass privatisation programme starts on November 22.

The Constitutional Tribunal rules in favour of a law restricting pension growth in 1996 to 2.5 per cent in real terms.

December

Pensions are increased by 14.9 per cent.

The state-owned Bank Gdanski is privatised.

On December 10, the surrender requirement applicable to foreign exchange earned by exporters is abolished.

On December 22, the central parity of the zloty is revalued in a step-appreciation by 6 per cent.

1996

January

The import surcharge rate is cut to 3 per cent, and the average tariff on industrial goods to 5.6 per cent.

The refinance window at the NBP is closed.

On January 8, the Lombard and rediscount rates are cut by two percentage points and the rate of crawl of the central parity of the zloty is slowed to 1.0 per cent per month.

Deputy Premier and Minister of Finance Kolodko proposes a medium-term policy programme, *Package 2000*.

February

A new coalition government is formed, headed by Prime Minister Cimoszewicz.

On February 7, the President signs the 1996 budget (passed by Parliament on February 1) into law.

On February 18, a referendum on privatisation is held, but the quorum is not reached.

As of February 29, the rate of required reserves on foreign exchange deposits is doubled, to 2 per cent.

April

On April 16, the government endorses *Package 2000*, with a few amendments.

May

Legislation easing the conditions for purchases of real estate by foreigners and relaxing foreign investors' entry requirements in so-called sensitive sectors becomes effective.

June

The Ministry of Finance accepts the bid of the Dutch bank ING to purchase 27.2 per cent of the stock of Bank Slaski still owned by the state, bringing ING's stake in Bank Slaski up to 53.1 per cent.

July

On July 1, the rate of required reserves on zloty demand deposits is cut to 17 per cent.

Wages in the budgetary sphere are increased by 20 per cent (more in selected sectors).

Poland issues a five-year, DM 250 million eurobond, priced with a spread of 65 basis points over comparable German state bonds.

A plenipotentiary for social security reform is appointed by the government.

On July 11, Poland is officially invited to join the OECD.

On July 16, the Lombard and rediscount rates are cut by one percentage point.

On July 16, the President signs the law on the consolidation of state-owned banks.

September

In the context of the reform of the central administration, 8 temporary heads of the ministries to be created are nominated, as well as 7 liquidators of ministries and offices to be abolished.

The Law on Commercialisation and Privatisation is signed by the President.

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Annex VI

STATISTICAL TABLES

Table A4. **Output of major products**

	1990	1991	1992	1993	1994	1995
Coal (mn tonnes)	148	140	132	130	134	137
Brown coal (mn tonnes)	67.6	69.4	66.9	68.1	66.8	63.5
Coke of hard coal (mn tonnes)	13.7	11.4	11.1	10.3	11.5	11.6
Natural gas (bn m^3)	3 867	4 132	4 019	4 949	4 635	4 803
Electricity (bn Kwh)	136	135	133	134	135	139
Fuel oils ('000 tonnes)	2 883	2 655	2 578	2 728	2 746	2 776
Refined oil (mn tonnes)	12.9	11.7	12.6	13.4	13.4	13.4
Caustic soda ('000 tonnes)	404	324	326	296	297	327
Crude steel (mn tonnes)	13.6	10.4	9.9	9.9	11.1	11.9
Rolled steel (mn tonnes)	9.8	8.0	7.5	7.6	8.6	9.0
Electrolytic copper ('000 tonnes)	346	378	387	404	405	407
Aluminium ('000 tonnes)	46.0	45.8	43.6	46.9	49.5	55.7
Sulphur ('000 tonnes)	4 660	3 935	2 917	1 894	2 163	2 427
Phosphatic fertiliser ('000 tonnes)	467	253	329	282	415	523
Nitrogenous fertiliser ('000 tonnes)	1 303	1 148	1 167	1 224	1 386	1 619
Pesticides ('000 tonnes)	19.7	17.0	21.8	22.3	20.7	24.2
Synthetic fibres ('000 tonnes)	150	106	111	114	138	137
Synthetic rubber and latex ('000 tonnes)	103.1	79.5	88.9	75.1	83.4	104.7
Tyres ('000)	5 896	5 189	6 547	7 521	8 929	10 880
Plastics ('000 tonnes)	627	596	650	671	651	735
Paints ('000 tonnes)	202	191	209	216	233	248
Metal cuttings machines (tonnes)	27 033	15 539	8 685	7 003	6 171	7 421
Washing powders ('000 tonnes)	243	224	194	211	241	227
Agricultural tractors ('000)	35.4	17.5	8.0	11.5	15.3	21.5
Cars ('000)	266	167	219	334	338	366
Heavy vehicles ('000)	39.0	20.1	17.7	18.8	21.4	30.7
Buses (units)	3 856	1 938	1 273	1 000	1 048	1 419
Freight cars (units)	4 154	2 301	678	362	249	835
Bicycles ('000)	1 339	971	814	745	973	1 090
Shipping over 100 dwt ('000 dwt)	227	329	464	613	538	551
Sewing machines ('000)	343	245	127	169	181	179
Refrigerators and freezers ('000)	604	553	500	588	605	585
Washing machines and dryers ('000)	482	336	363	402	449	419
Vacuum cleaners ('000)	913	857	961	1 001	1 143	1 156
Colour televisions ('000)	338	304	619	841	881	1 136
Radio sets ('000)	1 433	589	334	329	309	225
Taperecorders ('000)	299	108	58.9	22.2	14.3	12.1
Rechargeable cells ('000)	1 792	1 824	1 678	2 117	2 230	2 301
Light bulbs (mn)	213	209	201	216	246	277
Telephones ('000)	1 589	992	349	297	428	409
Cement (mn tonnes)	12.5	12.0	11.9	12.2	13.8	13.9
Paper ('000 tonnes)	924	949	1 031	1 070	1 199	1 335
Sawn wood (dam^3)	3 995	3 378	3 381	3 460	3 424	3 476
Fibre boards (mn m^2)	93	89	96	100	110	104
Cardboard ('000 tonnes)	141	111	116	114	127	142
Cotton fabric ('000 km)	428	286	239	229	256	205
Wollen fabric ('000 km)	64.7	44.3	32.9	31.8	33.4	32.6
Footwear (mn pairs)	105	71.1	58.6	50.7	56.3	62.8
Knitwear (mn)	183	114	83	85	111	127
Meat ('000 tonnes)	1 628	1 394	1 255	1 093	1 090	1 145
Cured meat products ('000 tonnes)	714	676	669	676	718	756
Sea fish ('000 tonnes)	430	410	448	360	414	. .
Butter ('000 tonnes)	272	192	155	146	120	122
Milk (mn hl)	20.4	14.0	12.3	11.8	12.6	12.6
Cottage cheese ('000 tonnes)	186	164	165	168	186	197
Sugar ('000 tonnes)	1 971	1 636	1 468	1 982	1 383	1 595
Concentrated fruit juices ('000 tonnes)	80	69	105	144	113	85
Edible plant fats ('000 tonnes)	279	289	355	423	468	550
Spirits ('000 hl)	1 510	1 457	1 357	1 495	1 566	1 539
Cigarettes (bn)	91.5	90.4	86.6	90.7	98.4	100.6

Source: Central Statistical Office.

Table A5. **Monetary survey**

End-quarter, million zloty

	Q4 1993	Q1 1994	Q2	Q3	Q4	Q1 1995	Q2	Q3	Q4	Q1 1996	Q2
Total money stock	55 924.4	59 103.1	63 039.1	68 824.1	77 301.8	81 307.1	87 397.9	94 588.9	104 254.6	110 636.7	116 909.3
Zloty money supply	39 833.7	42 102.3	44 989.3	49 159.5	55 243.2	59 237.0	66 726.0	73 814.4	82 954.9	89 509.5	95 375.3
Notes and coins in circulation (excluding vault cash)	9 982.4	11 474.9	12 159.1	12 809.1	12 273.8	14 479.7	16 715.8	18 025.5	19 529.4	20 644.3	22 345.7
Vault cash	2 200.6	1 860.3	2 069.8	1 929.3	2 506.2	2 016.0	2 201.9	2 115.6	2 880.4	2 423.6	2 531.4
Zloty deposits of non-financial sector	29 851.4	30 627.5	32 830.2	36 350.4	42 969.4	44 757.3	50 010.2	55 788.9	63 425.5	68 865.2	73 029.6
Personal	16 265.5	17 160.2	18 562.1	19 961.9	22 099.5	26 779.5	30 670.2	34 771.7	39 672.6	46 310.7	49 741.7
Demand deposits	1 406.2	1 722.1	1 802.1	1 955.2	2 289.6	2 736.0	3 196.2	3 607.2	4 470.7	5 952.2	6 925.8
Time deposits	13 710.6	14 252.5	15 478.3	16 694.3	18 364.1	22 471.3	25 774.3	29 380.3	33 160.0	38 138.7	40 482.6
Savings accounts	1 148.8	1 185.5	1 281.8	1 312.4	1 445.8	1 572.2	1 699.7	1 784.2	2 041.9	2 219.8	2 333.3
Corporate	13 585.9	13 467.3	14 268.1	16 388.5	20 869.9	17 977.8	19 340.0	21 017.2	23 752.9	22 554.5	23 287.9
Demand deposits	8 258.9	7 428.0	7 493.4	8 219.4	12 888.1	9 184.4	9 714.5	10 636.3	13 352.8	11 462.4	12 004.4
Time deposits	5 327.0	6 039.4	6 774.7	8 169.1	7 981.8	8 793.4	9 625.5	10 380.9	10 400.1	11 092.1	11 283.5
Foreign currency deposits of non-financial sector	16 090.7	17 000.7	18 049.8	19 664.6	22 058.6	22 070.1	20 671.9	20 774.5	21 299.7	21 127.2	21 534.0
Personal	15 431.0	16 228.3	17 185.7	18 708.9	20 906.3	20 912.0	19 725.4	19 783.6	19 712.1	19 222.4	19 415.9
Corporate	659.7	772.4	864.1	955.7	1 152.3	1 158.1	946.5	990.9	1 587.6	1 904.8	2 118.1
Net foreign assets	17 314.0	20 115.1	21 450.8	25 265.1	26 526.9	30 683.1	36 356.8	43 885.1	49 241.4	55 740.9	57 734.8
Net domestic assets	38 610.4	38 987.9	41 588.3	43 559.2	50 775.0	50 624.0	51 041.2	50 703.8	55 013.3	54 895.8	59 174.6
Lending to non-financial sector	33 195.7	35 316.2	36 977.7	38 625.2	41 562.1	44 748.8	47 891.8	51 913.3	56 212.6	59 559.4	64 158.4
Personal loans	2 259.4	2 428.7	2 590.6	2 920.6	3 344.3	3 548.8	4 101.5	4 715.6	5 620.5	6 402.6	7 822.5
Corporate loans	30 936.3	32 887.6	34 387.0	35 704.6	38 217.8	41 200.0	43 790.3	47 197.7	50 592.1	53 156.8	56 335.9
Net general government debt	30 028.9	30 376.7	33 172.9	35 091.1	40 471.1	42 473.5	40 783.9	39 785.7	41 775.3	41 412.3	44 623.9
Excluding Treasury bonds denominated in US dollars	18 111.1	17 802.1	20 223.2	21 362.3	23 400.7	31 834.7	30 881.6	29 482.5	31 745.0	30 526.0	32 134.0
Balance of other items (net)	–24 614.2	–26 705.0	–28 562.2	–30 157.1	–31 258.1	–36 598.4	–37 634.3	–40 995.4	–42 974.7	–46 075.9	–49 607.8

Source: National Bank of Poland.

Table A6. **Interest rates**

Per cent per annum

	NBP rediscount rate	Lombard rate	WIBOR[1] 3-month	Yield on 13 week T-bills	Weighted average lending rate of the main commercial banks	Zloty 3-month deposit rates
January 1994	29	33	34.3	33.6	42.2	20-31
February	29	33	31.1	30.6	42.2	20-31
March	29	33	33.2	29.8	42.2	20-31
April	29	33	33.2	30.0	42.1	20-31
May	28	31	32.4	29.7	39.3	20-30
June	28	31	31.8	28.9	37.1	20-30
July	28	31	31.7	28.2	36.8	20-30
August	28	31	31.0	27.4	36.6	22-30
September	28	31	30.5	26.8	36.6	22-29
October	28	31	30.3	26.9	36.6	22-29
November	28	31	29.6	27.0	36.5	22-28
December	28	31	29.0	27.0	36.8	22-28
January 1995	28	31	28.6	27.0	36.4	22-28
February	31	34	30.1	26.9	35.7	22-28.6
March	31	34	30.4	28.1	33.5	22-28.6
April	31	34	29.9	27.3	35.3	22-27
May	27	30	29.0	25.3	33.0	22-27
June	27	30	27.7	25.0	31.0	20-25
July	27	30	27.2	25.2	30.7	20-24
August	27	30	26.6	25.1	30.9	20-24
September	25	28	25.8	24.7	29.8	18-24
October	25	28	25.7	24.2	28.6	18-22
November	25	28	25.8	24.3	28.3	18-22
December	25	28	25.5	24.2	28.3	18-22.1
January 1996	23	26	23.0	23.1	27.3	16.5-19.5
February	23	26	22.7	21.5	26.6	16.5-19.5
March	23	26	22.7	21.4	26.6	16.5-19.5
April	23	26	22.7	21.4	26.4	16.5-19.2
May	23	26	21.9	21.3	26.5	16.5-19.2
June	23	26	21.6	21.0	26.2	16.5-19.2
July	22	25	20.5	20.2	25.7	15.5-19
August	22	25	19.7	19.4	24.9	15.5-18

1. Warsaw interbank offered rate.
Source: National Bank of Poland.

Table A7. **State budget**

Millions of zlotys

	1992	1993	1994	1995	Budget 1996
Revenue	**31 277.6**	**45 901.0**	**63 125.3**	**83 721.7**	**100 171.2**
1. Tax revenue	24 615.6	36 962.3	51 568.5	68 975.2	84 596.9
1.1 Indirect taxes	10 309.9	17 749.5	26 884.2	36 314.7	46 690.6
Turnover tax	10 309.9	9 409.5	129.5	41.7	0.0
Value added tax	–	5 129.1	15 013.9	20 673.4	25 698.6
Excise tax	–	3 120.3	9 001.7	12 139.9	18 087.0
Import surcharge	–	–	2 577.8	3 266.1	2 580.0
Poll tax	–	90.6	161.3	192.1	325.0
Tax on sale of securities	–	–	–	1.5	0.0
1.2 Income tax of legal entities	5 062.1	6 257.2	6 827.7	8 837.1	9 960.0
Enterprises	3 967.3	4 837.2	5 681.8	7 911.0	8 500.0
Financial institutions	1 094.8	1 420.0	1 145.9	926.1	1 460.0
1.3 Personal income tax	7 226.1	11 942.4	17 375.6	23 511.8	27 866.3
1.4 Tax on wage increases	1 698.8	998.7	469.3	166.9	0.0
1.5 Abolished taxes	318.7	14.5	11.7	144.7	80.0
2. Non-tax revenue	6 161.6	8 152.5	9 937.3	12 064.8	12 979.3
2.1 Dividends	848.2	691.4	599.5	805.8	1 461.0
Enterprises	823.2	495.2	492.6	610.3	1 311.0
Financial institutions	25.0	196.2	106.9	195.5	150.0
2.2 Transfers from the central bank	1 211.3	1 418.2	2 355.1	2 980.0	1 850.0
2.3 Custom duties	2 677.4	4 383.2	4 888.8	5 774.5	6 460.0
2.4 Revenue of budgetary units	1 139.4	1 308.2	1 535.9	1 970.0	2 613.0
2.5 Other non-tax revenue	285.3	351.5	383.8	510.0	530.0
2.6 Foreign grants	–	–	143.5	0.0	0.0
2.7 Import levies	–	–	30.7	24.4	0.0
2.8 Revenues from local governments	–	–	–	–	65.3
3. Privatisation receipts	484.4	780.4	1 594.9	2 641.6	2 565.0
3.1 Enterprises	480.5	726.4	1 169.7	2 120.3	2 165.0
3.2 Banks	3.9	54.0	425.2	521.3	400.0
4. Foreign revenue	16.0	5.8	24.6	40.1	30.0
Expenditure	**38 189.1**	**50 242.8**	**68 865.0**	**91 169.6**	**109 671.2**
1. Subsidies	1 984.0	1 956.5	2 458.5	2 994.2	3 134.5
2. Foreign debt service	1 176.4	1 211.1	1 832.1	3 262.6	4 725.0
3. Domestic debt service	2 438.3	4 749.9	7 400.9	11 097.1	13 214.0
4. Social insurance	7 345.3	10 420.7	14 273.4	15 309.7	17 303.6
5. Current expenditures	20 758.6	26 911.7	36 993.3	51 522.3	55 487.2
6. Settlements with banks	1 778.4	1 411.0	2 225.6	2 112.5	2 604.3
7. Capital expenditure	1 950.2	2 477.7	3 129.5	4 127.0	5 371.4
8. Subsidies to local authorities	757.9	1 104.2	551.7	744.2	7 725.3
9. Reserve of the Council of Ministers	–	–	–	–	105.9
Balance	**–6 911.5**	**–4 341.8**	**–5 739.7**	**–7 448.0**	**–9 500.0**
Financing					
1. Domestic	7 194.4	4 928.4	6 979.4	6 512.8	11 493.8
1.1 Banking	6 618.8	3 753.9	4 926.0	1 250.5	7 981.9
1.2 Non-banking	575.6	1 174.5	2 053.4	5 262.3	3 511.9
2. Foreign financing	–282.9	–586.6	–1 239.7	928.5	–1 993.8
Memorandum item: GDP	114 944.2	155 780.0	210 407.3	286 025.6	344 600.0

Source: Ministry of Finance.

Table A8. **Long-run evolution of consumer and producer prices**

Annual average percentage change

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1986-95
Consumer prices (CPI)	25.2	60.2	251.1	585.8	70.3	43.0	35.3	32.2	27.8	26 789
Food	21.7	49.4	320.1	574.7	46.1	36.9	33.6	33.0	27.0	23 157
Alcoholic beverages	28.2	68.2	247.9	388.7	87.6	36.5	23.6	29.2	28.6	19 177
Other goods	25.5	65.3	226.7	591.2	75.8	36.5	36.8	31.4	27.3	25 629
Services	30.9	63.5	170.9	780.7	131.5	67.6	38.1	32.5	29.3	46 767
of which:										
Residential rents	69.3	67.8	155.6	724.2	124.1	59.6	33.5	29.6	52.5	56 383
Central heating and hot water supply	51.4	90.9	54.4	1 203.5	222.8	222.5	68.4	65.9	31.3	222 004
Electricity and gas	23.5	79.1	85.2	1 297.0	217.0	94.6	34.2	34.7	26.7	80 765
Health	27.4	61.6	196.5	410.3	169.4	77.7	40.3	36.9	23.5	35 278
Public urban transport	41.9	96.0	292.7	720.7	120.9	59.8	48.4	34.0	27.3	79 992
Producer prices (PPI)[1]										
Total industry	26.6	59.8	212.8	622.4	40.9	34.5	31.9	25.3	25.4	
Mining	35.8	68.5	104.2	850.6	77.8	31.2	48.0	40.5	22.9	
Manufacturing	25.9	59.2	222.6	610.1	39.6	26.8	29.3	24.2	25.9	
Electricity, gas and water supply	. .	. .	. .	. .	40.5	86.7	40.1	23.6	27.1	

1. Index modified in 1991 and 1994.

Source: Central Statistical Office.

Table A9. **Balance of payments**[1]

Million US$

	1990	1991	1992	1993	1994	1995
Current account[2]	**716**	**–1 359**	**–269**	**–2 329**	**–944**	**–2 299**
Merchandise exports	10 863	12 760	13 997	13 585	16 950	22 878
Merchandise imports	8 649	12 709	13 485	15 878	17 786	24 705
Trade balance	2 214	51	512	–2 293	–836	–1 827
Services: credit	1 327	1 577	1 612	1 846	2 100	3 190
Transportation	438	608	755	853	848	1 062
Travel	268	104	152	131	126	222
Other	621	865	705	862	1 126	1 906
Services: debit	1 477	1 341	1 268	1 477	2 043	3 040
Transportation	497	348	218	242	272	457
Travel	388	124	132	181	316	422
Other	592	869	918	1 054	1 455	2 161
Services: net	–150	236	344	369	57	150
Investment income: credit	0	0	98	139	222	551
Investment income: debit	0	0	13	39	75	432
Investment income: net	0	0	85	100	147	119
Interest: receipts	581	541	527	400	272	472
Interest: payments	3 910	3 404	4 666	3 924	2 500	1 219
Due and paid	430	888	1 095	870	1 110	1 198
Due but not paid	3 480	2 516	3 571	3 054	1 390	21
Rescheduled	2 487	579	0	0	2	13
Cancelled	0	864	2 401	2 090	734	1
Converted	8	7	6	5	7	7
Arrears	985	1 066	1 164	959	647	0
Interest: net	–3 329	–2 863	–4 139	–3 524	–2 228	–747
Unrequited transfers: credit	6 320	7 153	8 319	7 874	7 200	6 046
Private	6 015	6 244	5 620	5 676	6 309	5 755
Official	305	909	2 699	2 198	891	291
Foundation	0	0	253	61	112	220
Foreign aid	257	0	0	0	0	0
Debt conversion	48	45	45	47	45	70
Debt forgiveness	0	864	2 401	2 090	734	1
Unrequited transfers: debit	4 339	5 936	5 390	4 855	5 284	6 040
Private	4 339	5 936	5 390	4 855	5 284	6 040
Unrequited transfers: net	1 981	1 217	2 929	3 019	1 916	6

Table A9. **Balance of payments**[1] *(cont.)*

Million US$

	1990	1991	1992	1993	1994	1995
Financial account	**–6 661**	**–5 259**	**–1 515**	**554**	**1 833**	**10 535**
Direct investment: net	10	117	284	580	542	1 134
Portfolio investment	0	0	0	0	–624	1 171
Long-term credits extended	42	43	21	11	–11	29
Long-term credits received	–4 205	–4 632	–1 289	–471	–1 043	132
Drawings	428	786	562	922	894	702
Repayments due	4 633	5 418	1 851	1 393	1 937	570
Due and paid	310	347	443	923	1 697	503
Due but not paid	4 323	5 071	1 408	470	240	67
Rescheduled	4 085	1 512	0	0	4	4
Converted	40	38	39	42	38	63
Arrears	198	3 521	1 369	428	198	0
Credit from IMF	479	322	0	–138	610	–1 400
Drawings	479	322	0	0	926	0
Repayments	0	0	0	138	316	1 400
Short-term credits extended	7	–46	–39	21	–21	–22
Short-term credits received	–339	8	–97	–74	–32	88
Other short-term capital	–2 648	–1 117	–434	646	2 391	9 381
Changes in other assets	–2 359	246	–1 460	–401	–1 620	1 006
Changes in other liabilities	–170	–147	292	–158	124	480
Other financial transactions	0	–596	–448	–545	676	141
Purchase/sale of foreign currencies	–119	–620	1 182	1 750	3 211	7 754
Errors and omissions	**360**	**–713**	**50**	**589**	**–228**	**–27**
Exceptional financing	**7 755**	**6 569**	**2 500**	**1 376**	**690**	**17**
Rescheduled obligations	10 685	2 091	0	0	6	17
Changes in arrears	–2 930	4 478	2 500	1 376	684	0
Valuation changes	**0**	**–58**	**–254**	**–217**	**418**	**731**
Official reserves	0	–29	–149	–106	235	503
Other assets and liabilities	0	–29	–105	–111	183	228
Change in gross official reserves	**–2 170**	**820**	**–512**	**27**	**–1 769**	**–8 957**

1. On a cash basis, convertible currency operations (since 1991 all settlements abroad have been in convertible currency).
2. Excludes unrecorded exports and imports.

Source: National Bank of Poland.

Table A10. **Warsaw Stock Exchange: Equities market**[1]

	1991	1992	1993	1994	1995	First half 1996
Number of listed companies (end-period)	9	16	21	36	53	62
Average capitalisation (Zl million)	79	307	1 962	8 928	9 030	16 961
in per cent of GDP	0.1	0.3	1.3	4.2	3.2	. .
Average capitalisation ($ million)	75	225	1 081	3 928	3 725	6 449
Number of sessions	36	100	152	188	249	124
WIG (end-period)	919	1 041	12 439	7 473	7 586	13 709
Number of orders per session	1 423	3 119	17 323	52 974	26 475	29 966
Turnover value per session ($ million)	0.8	1.7	28.1	53.0	20.2	43.2

1. Main market only.
Source: Warsaw Stock Exchange, Central Statistical Office.

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period [1]	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany	Greece
Population											
Total	Thousands	1994	17 840	8 031	10 124	29 251	5 206	5 088	57 960	81 407	10 430
Inhabitants per sq. km	Number	1994	2	96	332	3	121	15	106	228	79
Net average annual increase over previous 10 years	%	1994	1.4	0.6	0.3	1.6	0.2	0.4	0.5	2.9	0.5
Employment											
Total civilian employment (TCE)[2]	Thousands	1994	7 680 (93)	3 737	3 724 (92)	13 292	2 508	2 015	21 781 (93)	35 894	3 790
of which: Agriculture	% of TCE	1994	5.3 (93)	7.2	2.6 (92)	4.1	5.1	8.3	5.1 (93)	3.3	20.8
Industry	% of TCE	1994	23.7 (93)	33.2	27.7 (92)	22.6	26.8	26.8	27.7 (93)	37.6	23.6
Services	% of TCE	1994	71 (93)	59.6	69.7 (92)	73.3	68.1	64.9	67.2 (93)	59.1	55.5
Gross domestic product (GDP)											
At current prices and current exchange rates	Bill. US$	1994	331.6	198.1	227.9	544	146.7	97.2	1 328.5	1 832.3	73.1 (93)
Per capita	US$	1994	18 588	24 670	22 515	18 598	28 181	19 106	22 944	27 826	7 051 (93)
At current prices using current PPP's[3]	Bill. US$	1994	327.9	162.3	204.2	596.7	107	82.5	1 111.8	1 601.7	118
Per capita	US$	1994	18 382	20 210	20 166	20 401	20 546	16 208	19 201	24 325	1 450
Average annual volume growth over previous 5 years	%	1994	2.2	2.5	1.6	1.1	1.9	–1.6	1.1	2.6	1.4 (93)
Gross fixed capital formation (GFCF)	% of GDP	1994	21.4	24.8	17.4	18.7	14.8	14.3	18.1	18.5	17.4 (93)
of which: Machinery and equipment	% of GDP	1993	9.8	8.7	7.8	6.2	7.2	5.90	8.10	7.5	7.8
Residential construction	% of GDP	1993	5.2	6.3	4.6	6.1	2.9	3.7	4.9	6.5	3.6
Average annual volume growth over previous 5 years	%	1994	0.8	3.7	0.4	–0.1	–2.8	–12.9	–1	0.8	2.7 (93)
Gross saving ratio[4]	% of GDP	1994	16.8	25.3	22	16	17	16.6	19	21	15.5 (93)
General government											
Current expenditure on goods and services	% of GDP	1994	17.5	18.8	15	20.2	25.3	22.4	19.6	17.7	19.1 (93)
Current disbursements[5]	% of GDP	1993	36.9	48.4	55.3	49	61.1	58.9	51.5	45.6	51.2
Current receipts	% of GDP	1993	33.5	48.6	50.1	43	58.3	52.5	46.8	45.7	40.2
Net official development assistance	% of GNP	1993	0.34	0.31	0.41	0.46	1.03	0.76	0.66	0.44	..
Indicators of living standards											
Private consumption per capita using current PPP's[3]	US$	1993	10 803	10 546	12 090	11 863	10 042	8 814	11 395	10 733	6 367
Passenger cars, per 1 000 inhabitants	Number	1990	430	382	387	469	311	386	413	480[8]	169
Telephones, per 1 000 inhabitants	Number	1991	464	432	410	586	577	544	511	420[8]	413
Television sets, per 1 000 inhabitants	Number	1991	480	478	451	639	536	501	407	556[8]	197
Doctors, per 1 000 inhabitants	Number	1993	2.2 (91)	2.3	3.7	2.2	2.8 (92)	2.6 (92)	2.8	3.2 (92)	3.8 (92)
Infant mortality per 1 000 live births	Number		6.1	6.5	8	6.8	5.4	4.4	6.5	5.8	8.5
Wages and prices (average annual increase over previous 5 years)											
Wages (earnings or rates according to availability)	%	1994	3	5.5	3.7	3.3	3.5	4.8	3.5	5.2	14.6
Consumer prices	%	1994	3	3.4	2.8	2.8	2.1	3.3	2.5	3.3	16.2
Foreign trade											
Exports of goods, fob*	Mill. US$	1994	47 363	44 881	137 259[7]	165 358	41 850	29 514	235 337	422 243	8 958
As % of GDP	%	1994	14.3	22.7	60.2	30.4	28.5	30.4	17.7	23	11.5 (93)
Average annual increase over previous 5 years	%	1994	5	6.7	6.5	7.1	8.3	4.9	5.6	4.4	3.4
Imports of goods, cif*	Mill. US$	1994	49 731	55 071	126 006[7]	148 297	35 932	23 091	220 508	376 566	21 111
As % of GDP	%	1994	15	27.8	55.3	27.3	24.5	23.8	16.6	20.6	30.1 (93)
Average annual increase over previous 5 years	%	1994	4	7.2	5	5.4	6.1	–1.3	3.5	6.9	5.4
Total official reserves[6]	Mill. SDRs	1994	7 730	11 523	9 505[7]	8 416	6 203	7 304	17 986	52 994	9 924
As ratio of average monthly imports of goods	Ratio	1994	1.9	2.5	0.9	0.7	2.1	3.8	1	1.7	5.6

* At current prices and exchange rates.

1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Refers to the public sector including public enterprises.
10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics.*

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period [1]	Iceland	Ireland	Italy	Japan	Luxembourg	Mexico	Netherlands	New Zealand
Population										
Total	Thousands	1994	267	3 571	57 190	124 960	398	93 010	15 382	3 526
Inhabitants per sq. km	Number	1994	3	51	190	331	153	47	377	13
Net average annual increase over previous 10 years	%	1994	1.1	0.1	0	0.4	0.8	2	0.6	0.8
Employment										
Total civilian employment (TCE)[2]	Thousands	1994	138	1 168 (93)	20 152 (93)	64 530	162 (91)	32 439	6 631	1 560
of which: Agriculture	% of TCE	1994	9.4	12.7 (93)	7.5 (93)	5.8	3.7 (91)	25.8	4	10.4
Industry	% of TCE	1994	26.1	27.7 (93)	33 (93)	34	31.5 (91)	22.2	23	25
Services	% of TCE	1994	65.2	59.7 (93)	59.6 (93)	60.2	64.8 (91)	52.1	73	64.6
Gross domestic product (GDP)										
At current prices and current exchange rates	Bill. US$	1994	6.2	52	1 017.8	4 590	10.6 (92)	371.2	334.3	51.2
Per capita	US$	1994	23 199	14 550	17 796	36 732	27 073 (92)	3 991	21 733	14 513
At current prices using current PPP's[3]	Bill. US$	1994	5.1	54.3	1 068.4	2 593.7	11.7	673.3	285.9	57.3
Per capita	US$	1994	19 271	15 212	18 681	20 756	29 454	7 239	18 589	16 248
Average annual volume growth over previous 5 years	%	1994	0.6	4.7	1	2.1	4.1 (92)	3	2.3	2.5
Gross fixed capital formation (GFCF)	% of GDP	1994	15.2	15.1	16.4	28.6	20.4 (93)	20.7	19.3	20
of which: Machinery and equipment	% of GDP	1993	3.9	6.3	7.4	11.5	..	9.4	8.6	9.3
Residential construction	% of GDP	1993	4.4	4.1	5.3	5.4	..	4.9	5.1	4.9
Average annual volume growth over previous 5 years	%	1994	–4	1	–2.3	1.4	6.5 (92)	7.7	0.4	5.8
Gross saving ratio[4]	% of GDP	1994	16.9	19.5	18.8	31.2	60.2 (92)	15.1	24.4	20.7
General government										
Current expenditure on goods and services	% of GDP	1994	20.6	16	17.1	9.8	17.1 (92)	11.8 [9]	14.2	14.7
Current disbursements[5]	% of GDP	1993	34.9	..	53.2	26.9	..	..	55.4	..
Current receipts	% of GDP	1993	35.9	..	47.1	32.9	..	..	54.5	..
Net official development assistance	% of GNP	1993	..	0.15	0.42	0.27	0.34 (92)	..	0.88	0.22
Indicators of living standards										
Private consumption per capita using current PPP's[3]	US$	1993	11 546	7 750	11 029	11 791	15 545	4 853	10 726	9 266
Passenger cars, per 1 000 inhabitants	Number	1990	464	228	478	282	470	85	356	440
Telephones, per 1 000 inhabitants	Number	1991	527	300	400	454	511	70	477	436
Television sets, per 1 000 inhabitants	Number	1991	319	276	421	613	267	148	485	443
Doctors, per 1 000 inhabitants	Number	1993	3	1.7 (92)	1.7 (91)	1.7 (92)	2.1 (92)	1	2.5 (90)	2
Infant mortality per 1 000 live births	Number		4.8	5.9	7.3	4.5 (92)	8.5 (92)	18	6.3	7.3
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1994	..	4.6	5.9	2.4	..	5.3	3.2	2.1
Consumer prices	%	1994	6.3	2.7	5.2	2	3.1	16.1	2.8	2.5
Foreign trade										
Exports of goods, fob*	Mill. US$	1994	1 628	34 125	189 802	396 149	..	60 882	155 084	12 169
As % of GDP	%	1994	26.3	65.7	18.6	8.6	..	16.4	46.4	23.8
Average annual increase over previous 5 years	%	1994	2.7	10.5	6.2	7.6	..	21.7	7.6	6.5
Imports of goods, cif*	Mill. US$	1994	1 464	25 812	167 690	274 916	..	79 346	139 800	11 859
As % of GDP	%	1994	23.6	49.7	16.5	6	..	21.4	41.8	23.2
Average annual increase over previous 5 years	%	1994	0.7	8.1	1.9	5.5	..	25.5	6.1	6.1
Total official reserves[6]	Mill. SDRs	1994	201	4 189	22 102	86 214	..	4 301	23 655	2 540
As ratio of average monthly imports of goods	Ratio	1994	1.6	1.9	1.6	3.8	..	0.7	2	2.6

* At current prices and exchange rates.

1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Refers to the public sector including public enterprises.
10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics.*

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period [1]	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States
Population										
Total	Thousands	1994	4 337	9 900	39 150	8 781	6 994	60 573	58 375	260 651
Inhabitants per sq. km	Number	1994	13	107	78	20	169	78	238	28
Net average annual increase over previous 10 years	%	1994	0.5	–0.1	0.2	0.5	0.7	2.1	0.3	1
Employment										
Total civilian employment (TCE)[2]	Thousands	1994	1970 (93)	4 372	11 760	3 926	3 772	19 664	25 044 (93)	123 060
of which: Agriculture	% of TCE	1994	5.6 (93)	11.5	9.8	3.4	4	44.8	2.2 (93)	2.9
Industry	% of TCE	1994	23.1 (93)	32.8	30.1	25	28.8	22.2	26.2 (93)	24
Services	% of TCE	1994	71.3 (93)	55.7	60.2	71.6	67.2	33	71.6 (93)	73.1
Gross domestic product (GDP)										
At current prices and current exchange rates	Bill. US$	1994	103.4 (93)	87	482.4	196.6	257.3	130.7	1 019.5	6 649.8
Per capita	US$	1994	23 984 (93)	8 792	12 321	22 389	36 790	2 157	17 468	25 512
At current prices using current PPP's[3]	Bill. US$	1994	95.3	122	531.7	153	167.4	319.3	1 030.2	6 649.8
Per capita	US$	1994	21 968	12 335	13 581	17 422	23 942	5 271	17 650	25 512
Average annual volume growth over previous 5 years	%	1994	2.1 (93)	1.4	1.5	–0.3	0.5	3.6	0.8	2.1
Gross fixed capital formation (GFCF)	% of GDP	1994	22 (93)	25.7	19.8	13.7	22.8	24.5	15	17.2
of which: Machinery and equipment	% of GDP	1993	..	..	5.7	5.7	7.5	10.3	7.3	7.7
Residential construction	% of GDP	1993	..	..	4.1	4	14.9 [10]	9.1	3.1	4
Average annual volume growth over previous 5 years	%	1994	–3.93	2.7	–1.2	–7.6	–0.4	5.1	–2.1	4.6
Gross saving ratio[4]	% of GDP	1994	21.9 (93)	24.2	18.8	13.7	29.3	22.5	13.5	16.2
General government										
Current expenditure on goods and services	% of GDP	1994	22.1 (93)	17.2	16.9	27.3	14.1	11.7	21.6	16.4
Current disbursements[5]	% of GDP	1993	..	..	43.7	67.3	36.7	..	42.7	35.8
Current disbursements[5]	% of GDP	1993	..	..	40.1	59	36	..	36.8	31.7
Current receipts	% of GDP	1993	1.23	0.36	0.32	1.33	0.49	..	0.34	0.19
Net official development assistance	% of GNP	1993	9 826	7 780	8 412	9 240	13 730	3 617	10 942	16 444
Indicators of living standards										
Private consumption per capita using current PPP's[3]	US$	1993	378	260	307	418	441	29	361	568
Passenger cars, per 1 000 inhabitants	Number	1990	515	273	340	687	603	143	445	553
Telephones, per 1 000 inhabitants	Number	1991	423	187	400	468	406	175	434	814
Television sets, per 1 000 inhabitants	Number	1991	3.2 (92)	2.9	4.1	3	3	0.9	1.5 (92)	2.3 (92)
Doctors, per 1 000 inhabitants	Number	1993	5	8.7	7.6	4.8	5.6	52.6	6.6	8.5 (92)
Infant mortality per 1 000 live births	Number		4	..	7.2	5.4	..	..	6.7	2.8
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1994	2.7	9	5.6	5.7	3.9	73	4.6	3.6
Consumer prices	%	1994	34 645	17 072	73 129	61 122	70 467	18 456	205 170	512 627
Foreign trade										
Exports of goods, fob*	Mill. US$	1994	30.9 (93)	19.6	15.2	31.1	27.4	14.1	20.1	7.7
As % of GDP	%	1994	5	6.1	10.5	3.4	6.4	9.5	6.1	7.1
Average annual increase over previous 5 years	%	1994	27 345	25 967	92 182	51 730	68 126	22 976	227 026	663 256
Imports of goods, cif*	Mill. US$	1994	23.3 (93)	29.9	19.1	26.3	26.5	17.6	22.3	10
As % of GDP	%	1994	2.9	6.6	5.2	1	3.2	37.9	2.8	7
Average annual increase over previous 5 years	%	1994	13 033	10 627	28 475	15 929	23 790	4 911	28 094	43 350
Total official reserves[6]	Mill. SDRs	1994	5.7	4.9	3.7	3.7	4.2	2.6	1.5	0.8

* At current prices and exchange rates.

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2. According to the definitions used in OECD *Labour Force Statistics*.
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4. Gross saving = Gross national disposable income minus private and government consumption.
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