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Republic of Poland: Staff Report for the 1999 Article IV Consultation

This report was prepared by a staff team of the International Monetary Fund following discussions with the officials of Republic of Poland on economic developments and policies. The report was then considered by the IMF's Executive Board in the context of the IMF's periodic consultation with Republic of Poland, as required under Article IV of the IMF Articles of Agreement. The views expressed in the staff report itself are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF or of the authorities of Republic of Poland; a supplementary statement by IMF staff is also included. The views of the Executive Board as expressed in the discussion of the Article IV consultation report and as summarized in a Public Information Notice (PIN) are included too. In addition, a statement by the member country authorities may be appended. Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of Article IV staff reports allows for the deletion of market sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF POLAND

Staff Report for the 1999 Article IV Consultation

Prepared by the Staff Representatives for the
1999 Consultation with the Republic of Poland

Approved by Michael C. Deppler and Ishan Kapur

February 17, 2000

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1. The 1999 Article IV consultation discussions with Poland were held in Warsaw during November 30–December 15, 1999.[1] The mission met with: Deputy Prime Minister Balcerowicz (Finance Minister); National Bank of Poland (NBP) President Gronkiewicz-Waltz; several members of the Monetary Policy Council (MPC); senior officials in government ministries, the NBP, the Council of Ministers, and the office of the President; Parliamentary leaders; and representatives of the private sector and research institutions. Mr. Szczuka, the Alternate Executive Director for Poland, participated in many of the meetings. The Managing Director visited Warsaw during the mission, in honor of the 10th anniversary of transition in Poland.

2. Poland formally accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement of the Fund as from June 1, 1995, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.[2]

3. In concluding the 1998 Article IV consultation on March 11, 1999, Directors commended Poland's strong economic performance, notably sustained output growth and declining inflation. They approved of the intended rebalancing of economic policies—with continued fiscal consolidation accompanied by monetary relaxation—in response to the crisis in Russia in late 1998 and the slowing of growth in the EU. Directors welcomed the introduction of an inflation-targeting framework for monetary policy and considered the inflation target of not more than 4 percent by 2003 reasonable and achievable. They supported the parallel shift toward more exchange rate flexibility. Directors commended the authorities' initiatives for pensions, health care, and administrative reforms that took effect in early 1999 and called for similarly bold steps in industrial restructuring.

4. Opinion polls have moved against the center-right coalition government which came to power in late 1997. This largely reflects startup problems with structural reforms and frustration with the slow progress in EU accession. Strains within the coalition have posed an increasing challenge for economic policies: in November 1999, Mr. Balcerowicz threatened resignation in a dispute with his coalition partners over tax reform and more recently the Treasury Minister charged with privatization faced a vote of no confidence. The next Presidential and Parliamentary elections are due in late 2000 and 2001 respectively.

I. ECONOMIC BACKGROUND

5. **Poland has recently marked the tenth anniversary of its transition.** Progress during those ten years has put Poland consistently among the five most successful countries transforming from centrally planned to market economies, and is reflected in its investment grade ratings. As in those other countries, the focus of policies over the next decade will shift

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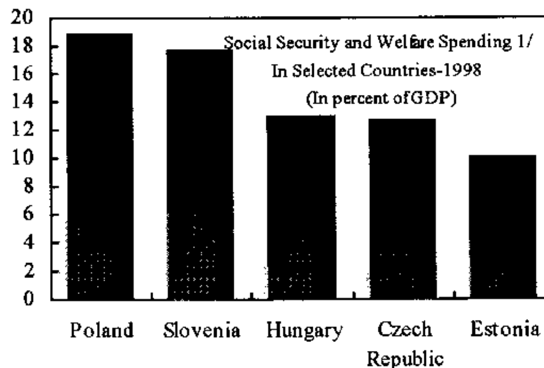
[1] The mission comprised Ms. Schadler (Head), Ms. Daseking, and Messrs. Doyle and Jiang (all EU1), and Ms. Summers (FAD), and Ms. Kiuru (Assistant EU1). Mr. Rozwadowski, the Resident Representative, assisted the team.

[2] Poland maintains United Nations-based exchange restrictions against Libya and Iraq, which have been approved pursuant to Decision No. 144-(52/51).

from managing the transition to securing a place among industrialized countries with stable and attractive investment conditions. The challenges in this task will substantially reflect the course transition has taken—building on Poland's comparative strengths in the transition process and addressing the problems remaining from the era of central planning.

6. **After successfully pioneering the shock therapy approach to stabilization and liberalization during 1990–91, Poland settled into a steady, step-by-step pace of transition during 1992–97.** Overall, Poland kept pace with the most advanced transition countries. Rapid progress was made with the commercialization and mass privatization of small and medium-sized enterprises, and the scale of governance problems in some other countries was avoided. But the restructuring and sale of larger enterprises has been drawn out, owing to resistance of entrenched interests and efforts to maximize revenues (Figure 1). Sales of banks began in 1993 but proceeded more slowly than planned—by 1998 half of bank assets were still in state banks. Tax reform moved at a faster pace: direct income taxation and a VAT were introduced in the early 1990s; corporate income tax rate reductions and a honing of the tax code have occurred since then. This, as well as improvements in the legal system, hardened enterprise budget constraints and enhanced the investment climate. Foreign trade benefited from the almost complete elimination of exchange and trade controls during 1990–92 and reductions in tariffs in the mid-1990's.

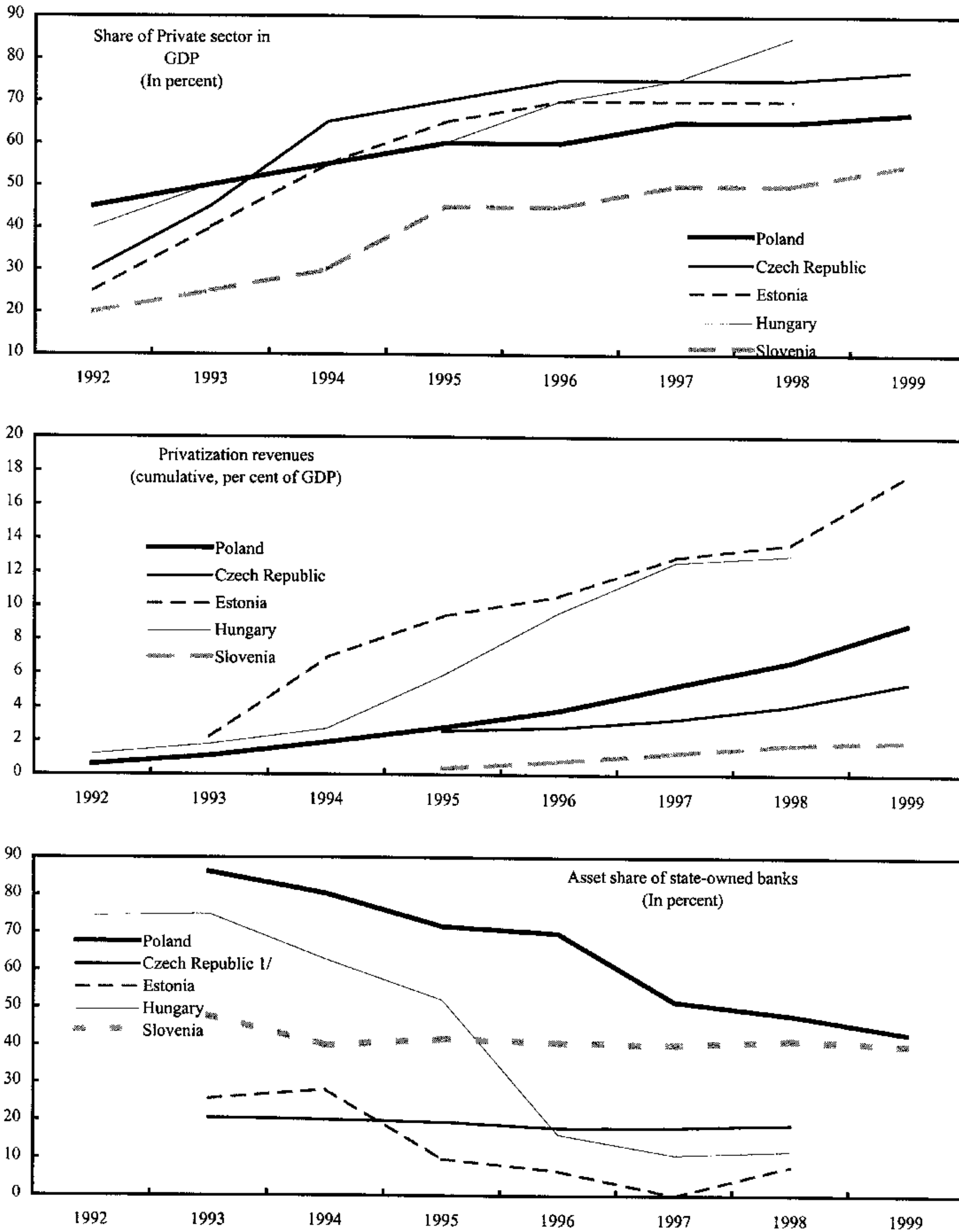
7. **The aggressiveness with which large fiscal deficits and inflation were addressed also moderated from that in the initial stabilization period, but efforts were strong and well-focused.** With the introduction of the VAT in 1993, revenue rose sharply, and the general government deficit fell to about 3 percent of GDP. Thereafter, the effects on the deficit of a steady containment of spending relative to GDP and the debt write-off in 1994 were largely offset by a declining ratio of revenue to GDP. Though falling, the government spending ratio, and particularly that on transfers to households, is high in Poland relative to other advanced transition countries. Deficits were financed mainly by domestic borrowing, which has kept interest rates high and, with accommodative capital inflows, the pace of disinflation gradual. A crawl in parity at rates below concurrent inflation helped moderate price increases. Between 1992 and 1997, inflation fell from over 40 to 15 percent.



Source: Government Finance Statistics and WEO.
1/ Data consolidated for central government.

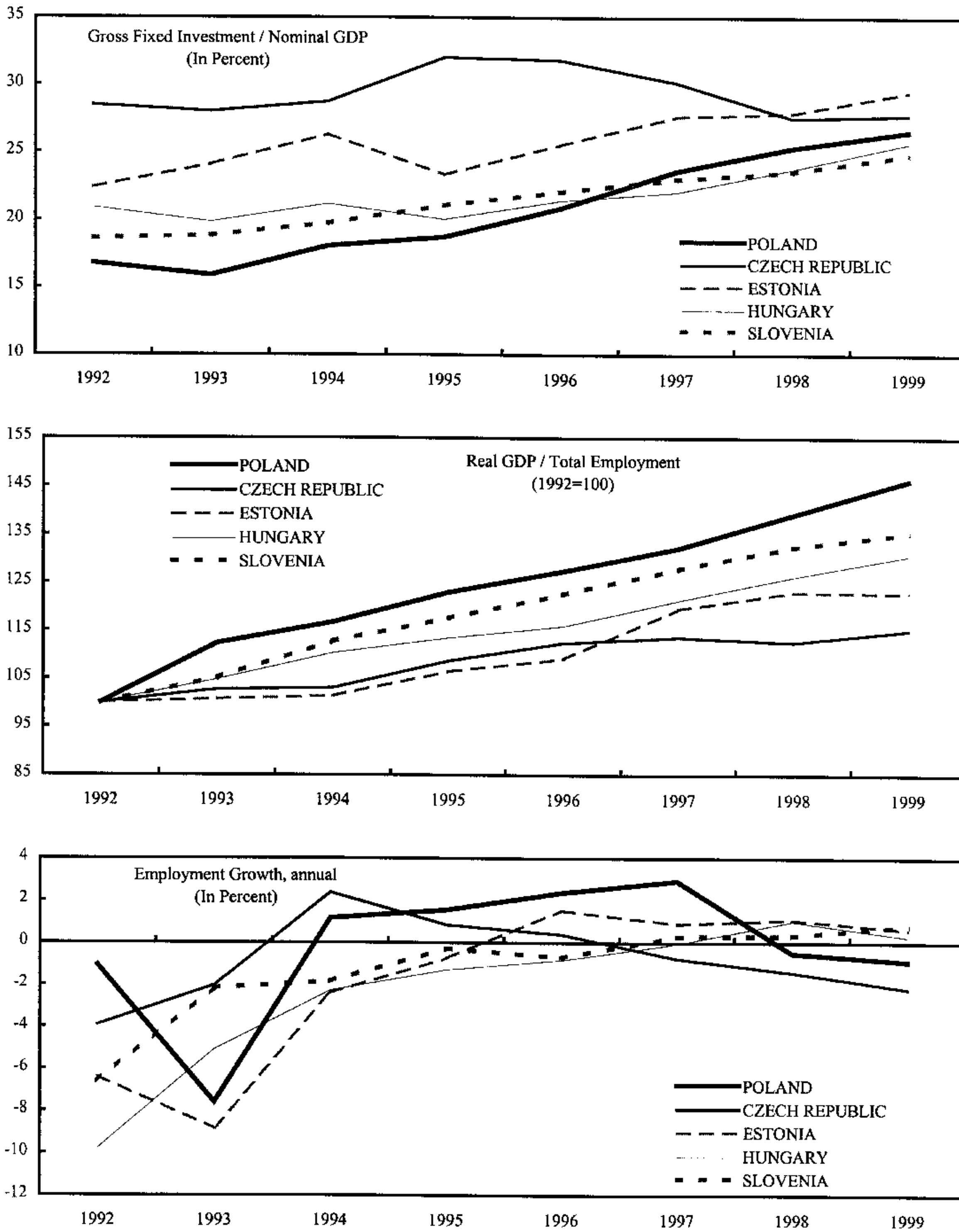
8. **On several fronts, macroeconomic performance improved dramatically during 1992-97.** What stands out, relative even to the other advanced transition countries, is the steady rise in gross investment, rapid productivity growth and increase—albeit modest in comparison to the high unemployment rate—in employment (Figure 2). Correspondingly, output growth,

Figure 1. Poland: Structural Reform Indicators in Selected Transition Countries, 1992-99



Source: EBRD Transition Report 1999.
1/ Excludes Ceska Sporitelna and Komercni Banka.

Figure 2. Poland: Investment and Productivity in Selected Transition Countries, 1992-99



Source: WEO.

averaging over 5 percent per year, exceeded that in other advanced transition countries, and the unemployment rate fell (although reductions in the labor force contributed). The pace of Poland's integration with the outside world also stands out: with competitive unit labor costs and low barriers to imports, the ratio of foreign trade to GDP rose by half. And helped by the restructuring of external debt in 1994, the ratio of debt to GDP dropped sharply, paving the way for large capital inflows—about half in direct foreign investment—in 1996–98.

9. **Thus, by 1997, Poland had secured a strong position among the transition countries but still faced substantial challenges.** Most fundamentally, evidence of the dynamism of Poland's private sector is strong: a recent EBRD/World Bank survey of firms' views of the investment climate shows Poland as one of the most attractive among transition countries owing particularly to the legal and regulatory system, availability of finance, and quality of infrastructure; growth during the 1990s was built on robust small and medium size business entry and expansion; and, with competitive labor costs and strong productivity growth, the profitability of traded goods is high. Yet even after eight years of remarkable adjustment and reform, the agenda of unfinished items was substantial: the agricultural sector, absorbing up to 25 percent of the labor force and producing only 6 percent of output, needed consolidation and modernization; the restructuring and privatization of large state enterprises and banks needed to move ahead; and the fiscal deficit and government spending remained high.

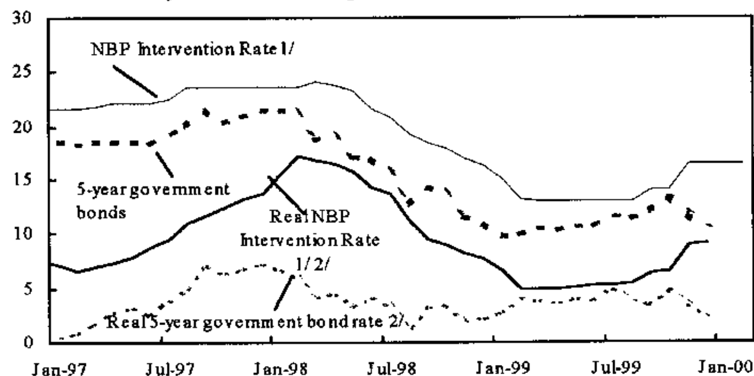
10. **The new government that took power in late–1997 acted quickly on its mandate to accelerate reforms.** Displaying the hallmark Polish confidence in markets, reforms in many critical structural areas have picked up. A new thrust of privatization, aimed at selling, primarily to strategic investors, all but a handful of remaining state enterprises by 2002, started in 1998 and remains broadly on schedule. Privatization revenues amounted to 1.3 percent of GDP in 1998 and 2.2 percent in 1999. A restructuring of the coal sector began in earnest in 1998, supported by the World Bank: mines have been closed, production cut and some 25 percent of the coal workforce has accepted redundancy packages or early retirement.[3] Bank privatization picked up speed with the sale of two large state banks in 1999. On the fiscal side, a wholesale reform of government operations was initiated with effect from early 1999. This comprised introducing a multi-pillar pension scheme; devolving much more of the authority for public spending to local governments; initiating a multi-stage process for establishing an internal market in the public health system; and reforming the education system up to secondary school level. In late 1999, Parliament passed a major tax reform: it substantially reduces corporate taxes, closes corporate tax loopholes, and broadens the VAT in a revenue-neutral manner.

11. **These reforms were implemented in an adverse economic environment.** In 1998–99, the macroeconomy faltered for the first time since the early 1990s. Hit hard by the Russian crisis in mid–1998, Poland sustained a sharp drop in exports and sizable, albeit short-lived, downward

[3] Chapter IV of the Selected Economic Issues paper describes progress with industrial restructuring in 1998–99.

pressure on the zloty.[4] With an additional drag from the slowdown in EU demand, the loss of competitiveness to Asian countries, and the lagged effects of a countercyclical monetary tightening in 1997, real GDP growth slipped from about 5 percent in 1998 to about 2 percent in the first half of 1999. Registered unemployment reversed a four year drop and rose to 13 percent in 1999. The current account deficit widened to 7.6 percent of GDP in 1999, reflecting the export demand shock on top of a structural trend of rising investment and unchanged savings ratios (Figures 3 and 4). Disinflation continued through mid–1999 helped by excess agricultural stocks as Russian demand fell; inflation reached a low of 5½ percent in early–1999. These developments broadly parallel those elsewhere in the region: all countries struggled with the same external shocks that weakened growth and current account positions.[5] The recorded weakness in Poland's exports, however, stands out (Figure 5). A drop in competitiveness in 1998 (subsequently reversed) explains some of the weakness (Box 1). But the experience of the other countries strengthens the staff's suspicion that the extent of the weakness in recorded exports is overstated due to the discontinuity in data collection.

12. **In response to the external shocks, the authorities attempted to rebalance macroeconomic policies**—essentially to bolster exports and activity while containing inflation. The monetary easing that had begun in early 1998 continued into early 1999—the last of the interest rate cuts being associated with a fall in the value of the zloty from some 8 percent above parity to close to parity early in 1999, while yield spreads on Polish sovereign bonds remained tight.

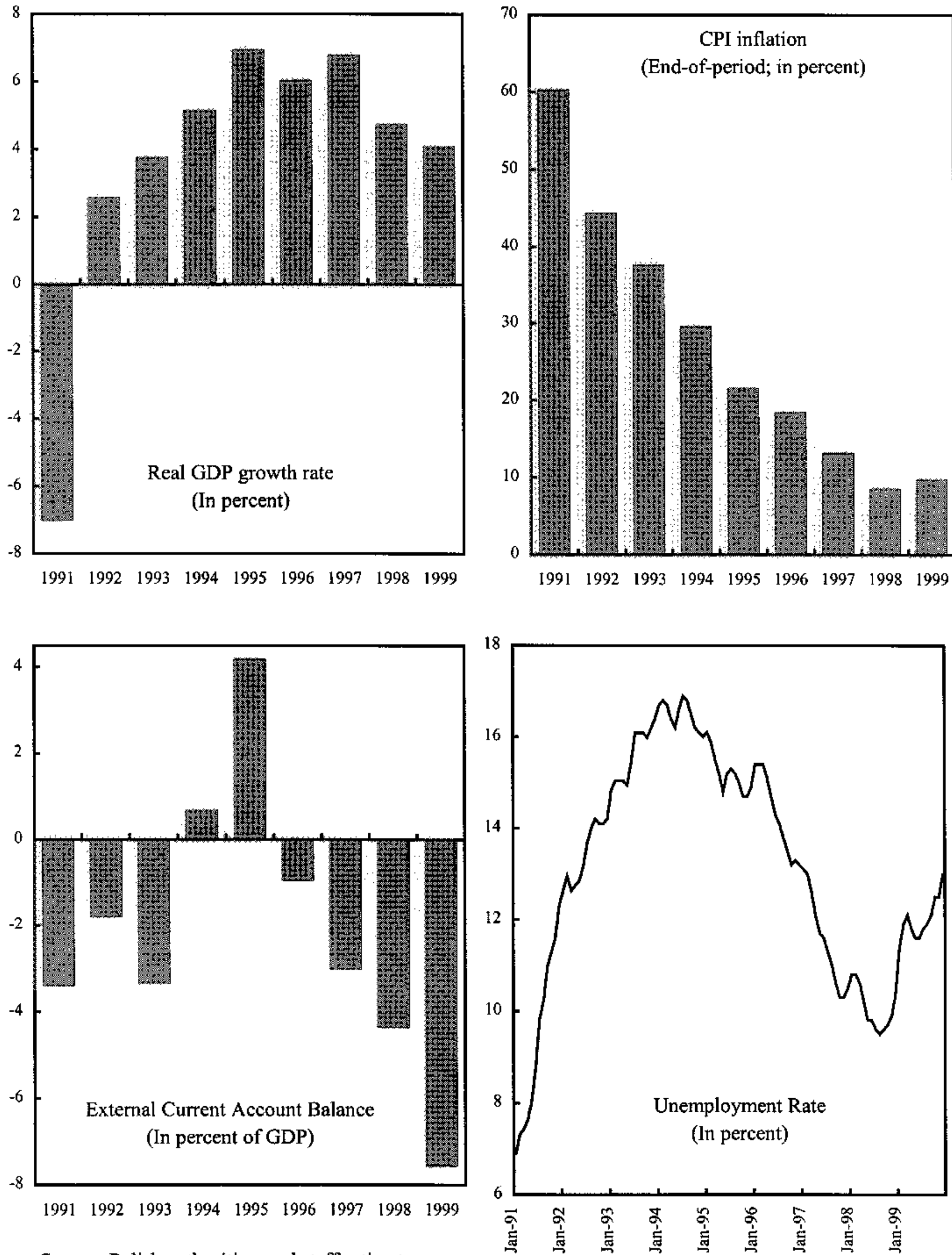


Source: Polish authorities.
1/ 14 day reverse repo up to February 1998 and 28 day reverse repo rate afterwards.
2/ Nominal rates deflated by one year ahead CPI. For 1999, interest rates are deflated by the CPI target for 2000.

[4] Official balance of payments data suggest that, after rising annually by 9 percent during 1995-97, merchandise export receipts fell by some 12 percent in 1999, even after an end-year rally. However, the change in 1999 appears to considerably understate the actual change owing to improved reporting standards that essentially destroy the comparability of export data in 1999 with those in earlier years. Consistent customs data show a smaller drop and partner country data suggest Polish exports grew in 1999. Since similar changes in reporting standards were applied to imports, the true drop in imports was probably also smaller than reported so the measurement of the trade and current account balances was likely unaffected.

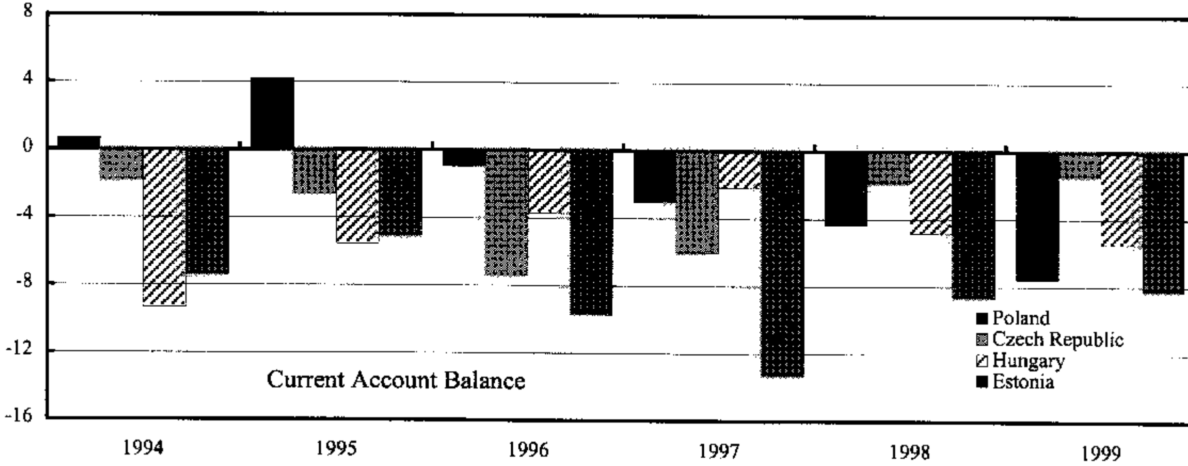
[5] See Staff Report for the 1999 Article IV Consultation with Hungary (EBS/00/25) and Slovenia (EBS/00/30).

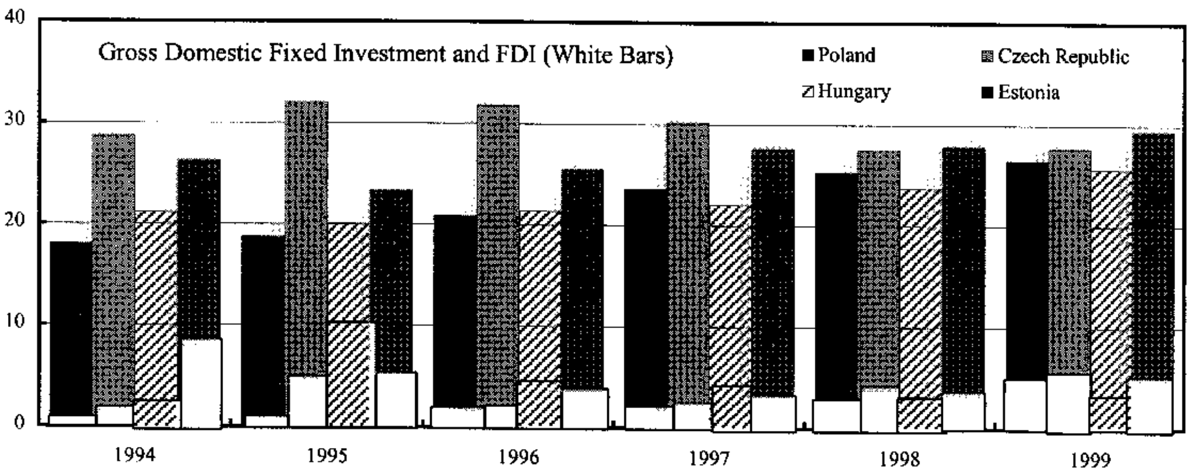
Figure 3. Poland: Selected Economic Indicators, 1991-99

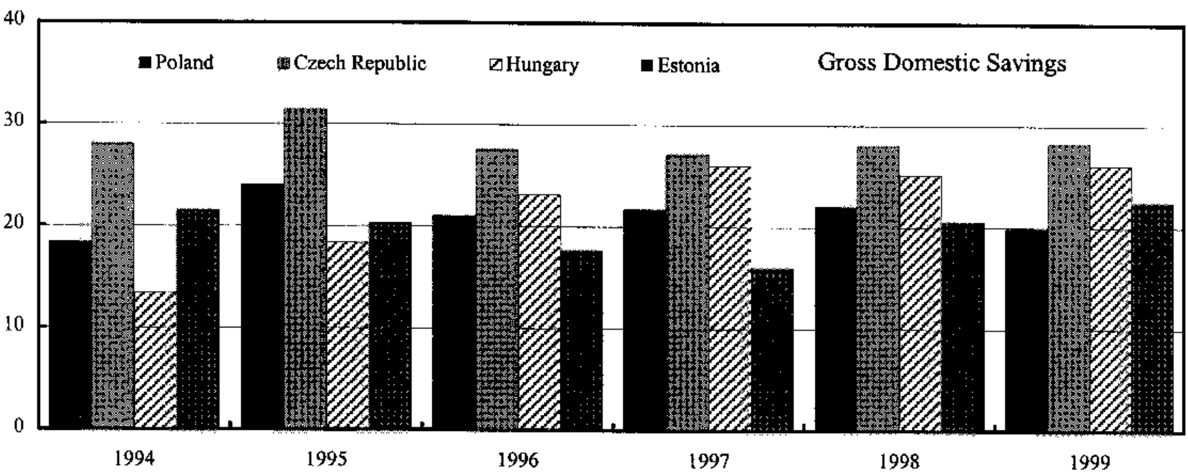


Source: Polish authorities, and staff estimates.

Figure 4. Poland: Savings-Investment Balances in Selected Central European Countries, 1994-99

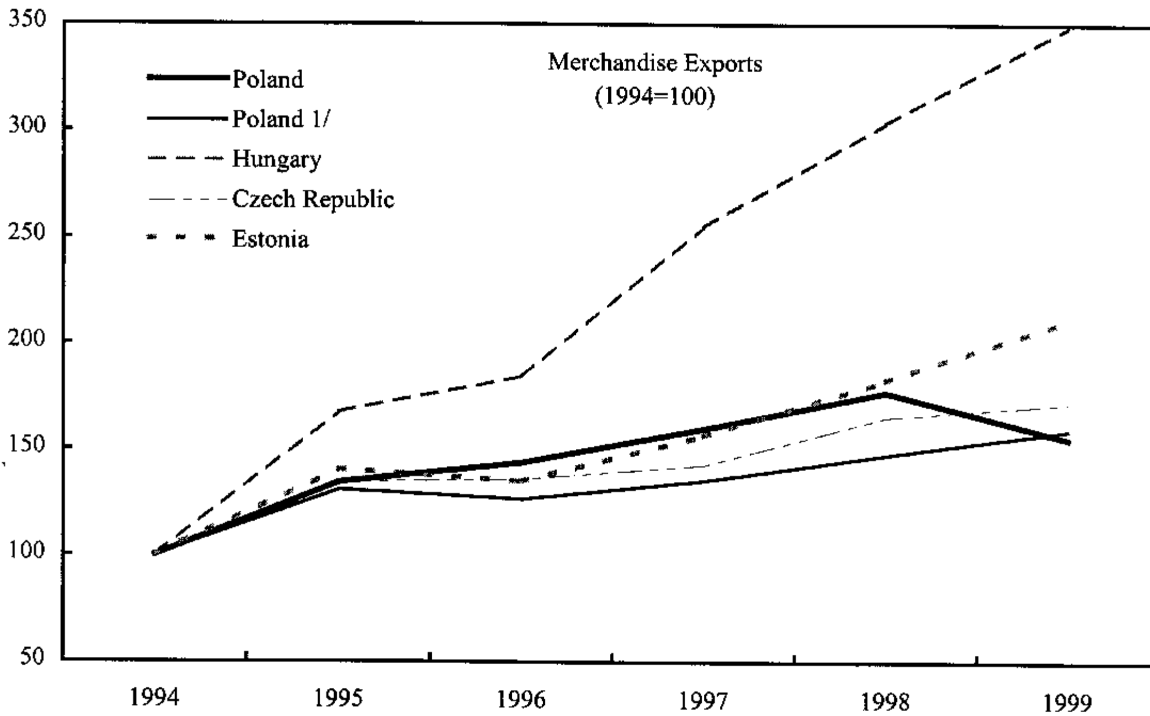


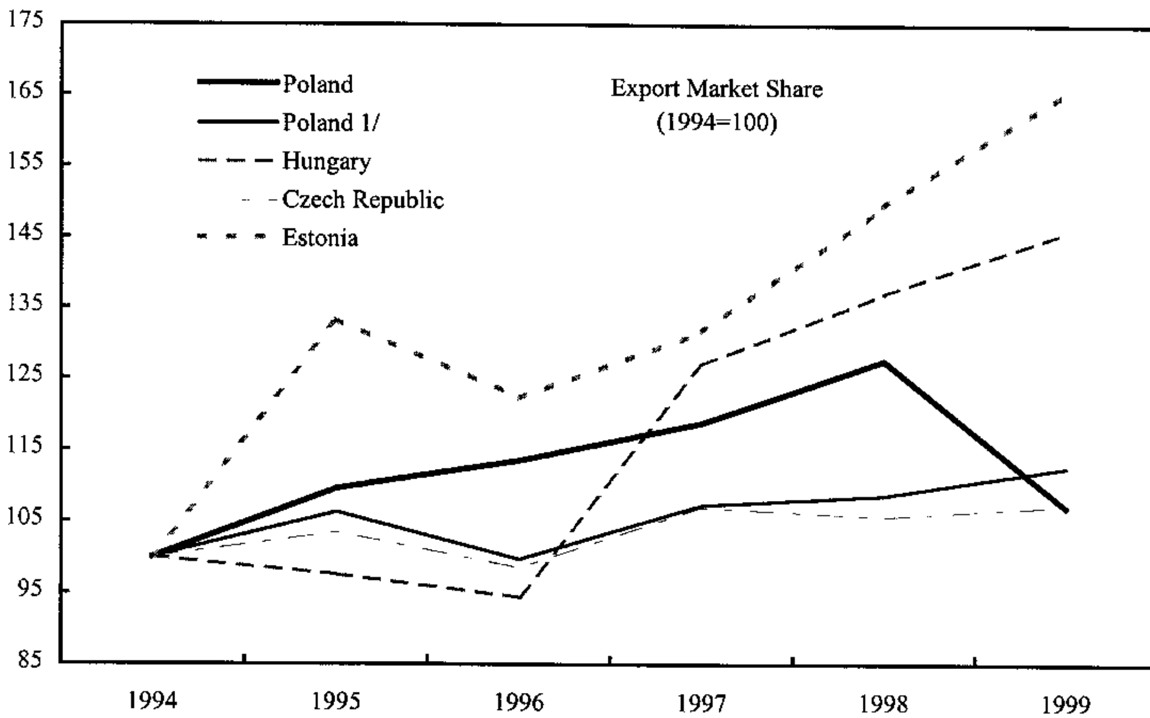




Source: WEO.

Figure 5. Poland: Export Performance in Selected Central European Countries, 1994-99





Source: WEO, DOTS and staff estimates.
1/ Based on DOTS export growth.

Box 1. Trends in Polish Competitiveness 1998–99

During 1998, a sizeable nominal appreciation of the zloty helped disinflation, but resulted in a marked appreciation of the CPI- and PPI- based REERs (Figure 6).[1] RULCs and profit share in manufacturing deteriorated, and the external current account deficit rose. Also, the price of traded goods fell vis-à-vis nontraded goods. In early 1999, however, the zloty depreciated by some 8 percent. The impact on competitiveness is apparent from all indicators, notably the RULC and the profitability of export production (the inverse of real unit labor costs). But the depreciation did not reverse the trend decline in the price of tradeables relative to nontradeables.

Two conclusions are suggested by these data for policy. First, lagged effects of the deterioration in competitiveness in 1998, compounded by weakening export market growth explain at least part of the officially-reported weakness of exports in 1999. But the deterioration in unit labor costs and in export profitability recovered during 1999. Second, the increase in the price of non-traded to traded goods, which has persisted, probably reflects Balassa-Samuelson effects to a large extent, as well as administered price increases which disproportionately affect non-traded goods. The Balassa Samuelson effect makes the task of lowering headline CPI more onerous.

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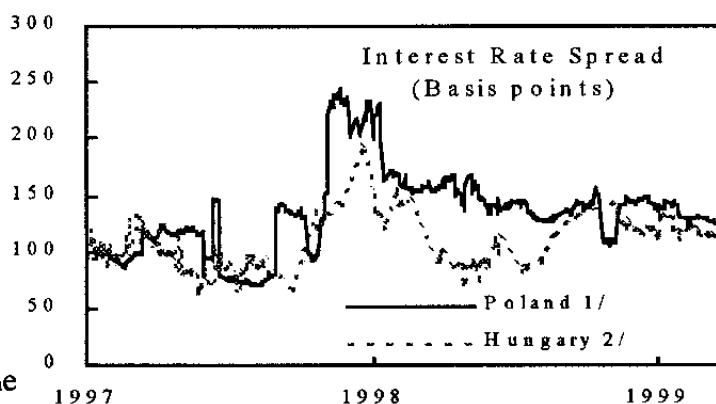
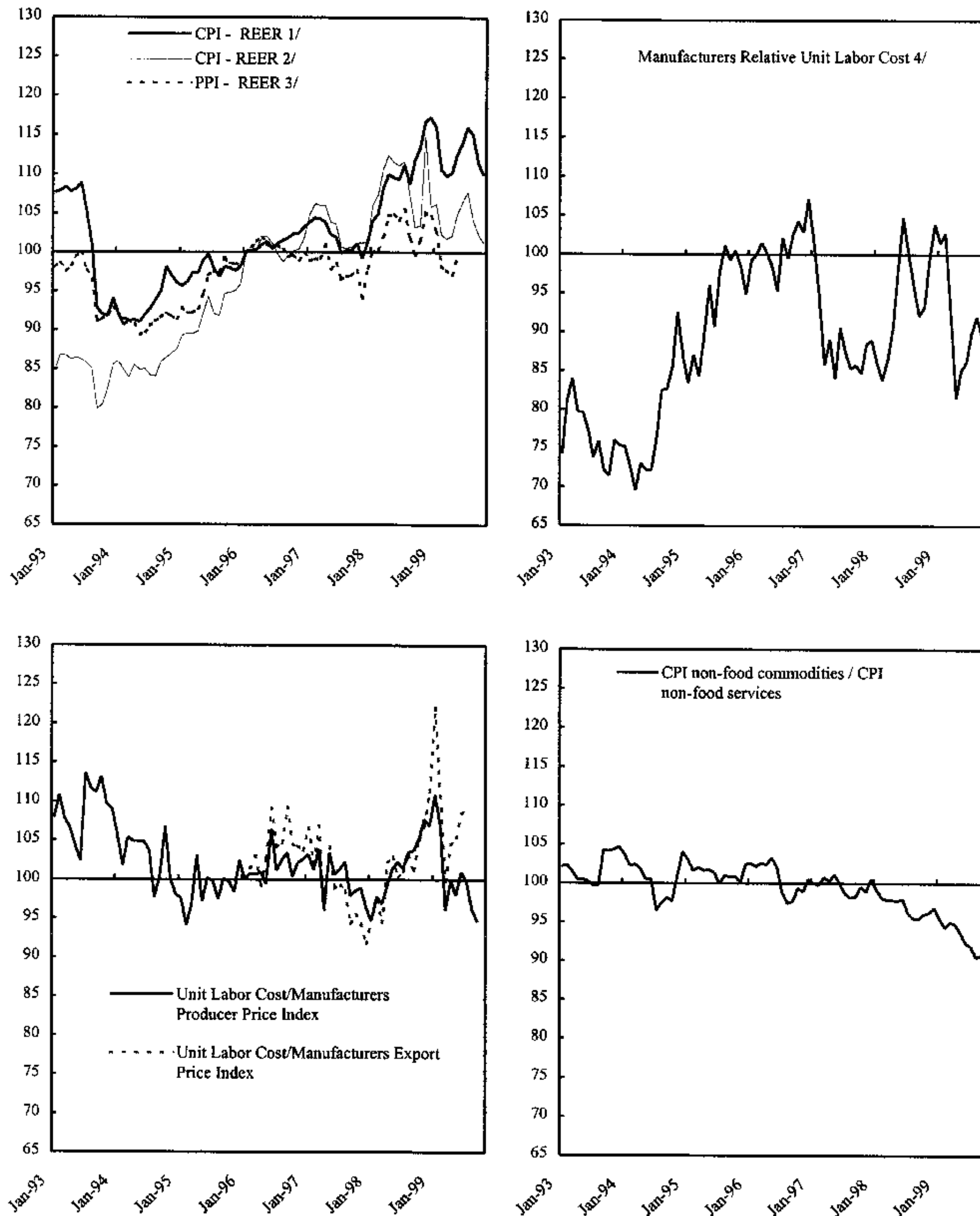
[1] The drop in competitiveness in 1998 may be understated because INS weights are based on 1989 data, implying that Asian countries are likely underrepresented in Poland's index and the effect of their depreciation on Poland's competitiveness in 1997-98 is not captured in Figure 6.

Until late-1999 the monetary stance was broadly neutral. On the fiscal side, however, a planned reduction in the general government deficit relative to GDP of ½ percentage point failed to materialize. Though cyclical factors played a part in this, the slippage mainly reflected teething problems with the 1999 reforms of the pension system. The deficit of general government looks set to come out at 3.8 percent of GDP in 1999, overshooting its target by 1½ percent of GDP on a commitment basis (Box 2).



Source: WEO and Bloomberg.
1/ Spread on Polish bond 7.25 coupon expiring 07/04 and US Treasury 7.25 expiring 08/04
2/ Spread on Hungarian bond 8.8 coupon expiring 10/02 and US Treasury 5.75 coupon expiring 10/02

Figure 6. Poland: Competitiveness Indicators, 1993-99
(January 1996=100)



Source: Polish authorities, Information Notice Systems and staff estimates.

1/ Based on weights for Austria, Australia, Belgium, Canada, China, Denmark, Finland, France, Germany, Hungary, Italy, Japan, Netherlands, Romania, Russia, Spain, Sweden, Switzerland, Taiwan, UK and USA. Weight for Russia calculated using DOTS and unclassified transactions.

2/ Based on INS weights which do not include Russia. For other countries in INS see footnote 1.

3/ Based on weights for Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, UK and USA.

4/ Based on weights for Germany, Italy, Canada, France, UK and USA. Polish unit labor Cost/Partner country unit labor cost.

Box 2. Fiscal Slippage in 1999

In 1999, the authorities targeted a deficit of 2.3 percent of GDP for general government. They projected the 1999 outturn to be 3.8 percent of GDP on a commitment basis, a slippage of Zl 8.9 billion (Table 5).

The slippage occurred almost entirely in the social security system (FUS), with the remainder (Zl 2.0 billion) accounted for by unpaid interest on the stock of expenditure arrears. With respect to FUS, first, many contributors exploited a loophole in the legislation reforming social security to postpone all their contributions by one month, giving rise to a "one month" loss of revenue during 1999. Second, fraud in the sickness benefit system, which had been targeted for reduction, remained substantial through the first three quarters. Finally, collection ratios fell in 1999 reflecting financial difficulties in some state-owned firms and some loss of taxpayer payment discipline in the context of a collapse of the FUS management information system.

The central government budget on a cash basis, however, remained on track: cyclical slippages in revenues were offset by midyear increases in excise tax rates and cuts in expenditure allocations. The FUS deficit overrun was funded by commercial and central government credit, rather than by central government transfers, which many observers thought would have been more transparent. The authorities avoided a mid-year increase in central government transfers in part because of concerns that the required Parliamentary approval for the overrun of the central government deficit could have been accompanied by added spending commitments.

Selected quarterly growth rates in 1999
(percent changes over the same quarter in the previous year)

	Q1	Q2	Q3	Prel. Q4	Prel. 1999
Real GDP	1.6	3.0	5.0	6.4	4.1
Real domestic demand	3.3	4.6	5.5	5.3	4.9
Private consumption	4.3	4.9	5.3	5.4	5.0
Gross capital formation	1.1	6.5	9.0	7.2	6.5
Fixed investment	6.1	6.8	7.0	7.2	6.9
Contribution of net exports to real GDP growth	-1.8	-1.8	-0.9	0.5	-0.9
Credit to households	33.7	39.1	46.0	54.2	42.7
Industrial sales	-3.1	1.2	7.4	11.7	4.4

13. **A strong recovery of growth began in early 1999.** Alongside the stabilization of the Russian market and the pick-up in EU demand, investment and household demand accelerated from the first quarter. This was reflected in a sharp increase in credit to households, industrial sales and GDP growth. At the same time, the long-standing downward momentum in inflation was interrupted as year-on-year price increases rose to 9.8 percent in December. The official target of 6.6–7.8 percent inflation in December 1999 was therefore exceeded by 2 percentage points. Although measures of core inflation have risen, increases in the CPI also reflect rising oil prices and the weakening of the zloty (Figure 7). Wage increases have, however, remained moderate.

14. **The Monetary Policy Committee (MPC) reacted decisively to these developments** by raising the central intervention rate by 100bp in September and by a further 250bp in November. These actions and a subsequent easing of political tensions saw the zloty strengthen by some 5 percent during December–January, while yield spreads on Polish sovereign paper tightened further.

15. **The current account deficit for 1999 has turned out to be substantially larger than was projected during the December mission.** Then, the authorities and staff projected a deficit of about 7 percent of GDP. But a much weaker than expected outturn for December left the deficit for the year at 7.6 percent of GDP. This sharp drop reflected strong imports and a large drop in "unclassified transactions," despite strong exports. The reasons for these weaknesses and the degree to which they reflect permanent or soon-to-be reversed developments are not yet understood.

II. Report on the Discussions

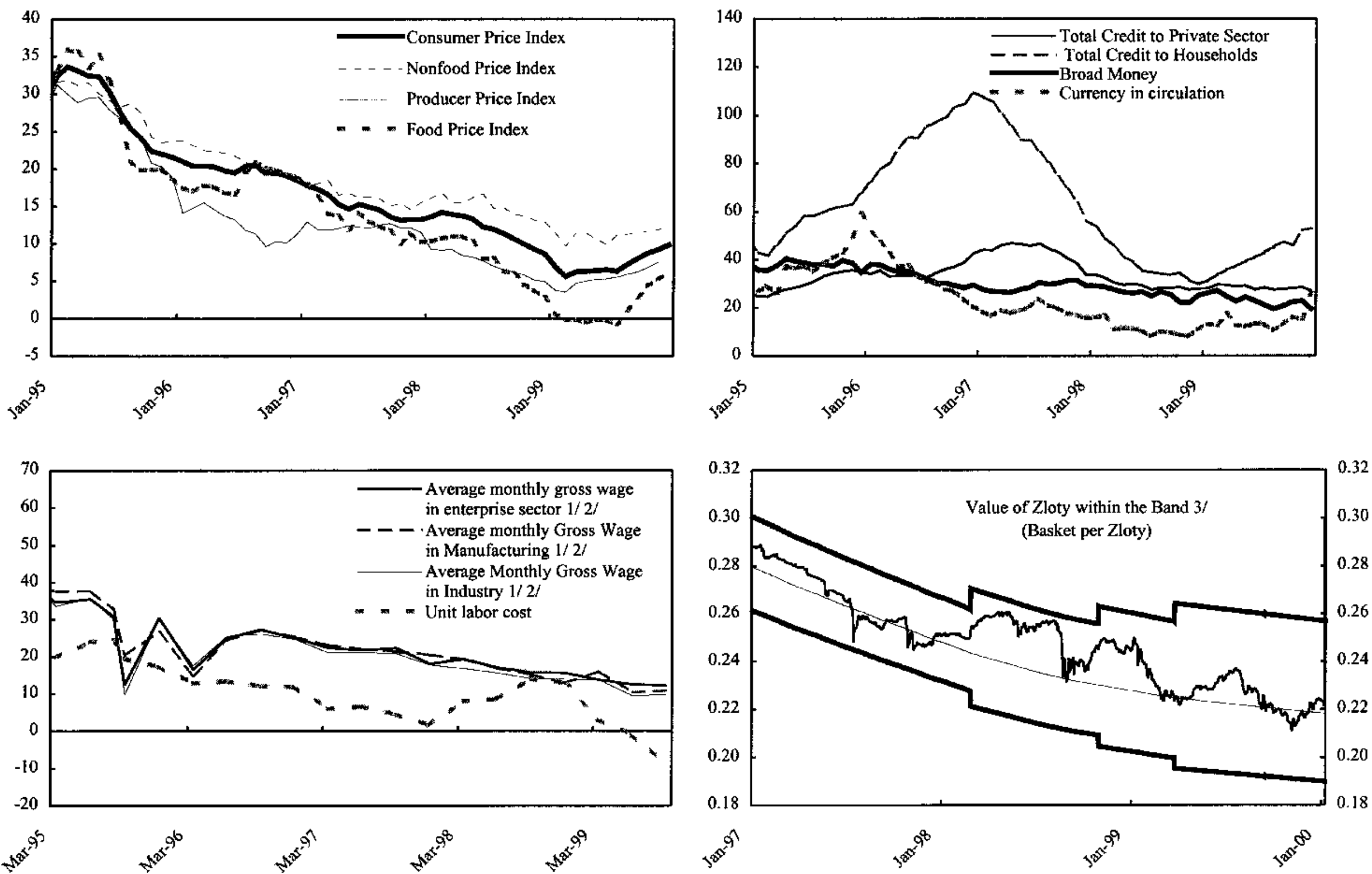
16. **With transition well advanced, Poland has now set its sights squarely on early accession to the European Union.** The enthusiasm of politicians across the party spectrum for EU accession at the earliest possible date together with the propitious cyclical position of the economy means that the next few years should present unprecedented opportunities for moving ahead with structural reforms. Beyond the acceleration of reforms since 1998, EU accession will force the issues of agricultural reform, environmental protection, scaling down production in the steel and defense sectors, as well as a broad array of legal and regulatory changes. The prospect of EU entry also has enormous implications for macro policies. Over the medium run when Poland will enter ERMII, macroeconomic policies will be anchored by the Maastricht criteria. More immediately, however, making room for needed infrastructure, environmental and restructuring expenditures heightens the importance of containing other government spending. Equally important, minimizing vulnerabilities to changes in market sentiment will remain crucial during the accession effort.

17. **The authorities' program to address these challenges is outlined in "The Strategy of Public Finance and Economic Development Poland 2000–2010"** which was adopted in mid-1999. It anticipates a balanced budget for general government in 2003, restraint in public spending, privatization, liberalization of the labor market, and an improved legal and regulatory environment. In this context, inflation is projected to fall to 3 percent by 2003, fixed investment to rise above 30 percent of GDP, and growth to rise to 6–8 percent.

18. **The discussions focussed on four themes in this agenda.**

- **With high productivity growth and moderate wage increases, Poland is likely to have persistently strong capital inflows, high investment ratios, and large current account deficits**. A balance has to be struck between exploiting the opportunities for rapid investment growth and limiting the vulnerability to changes in market sentiment consequent on large external current account deficits. This vulnerability may be heightened if prospective EU accession takes country risk premia below levels warranted by the strength and credibility of prospective Polish policies.

Figure 7. Poland: Indicators of Inflation, 1995-99
(12-month growth)



Source: Polish authorities, INS and staff estimates.

1/ 1999 Wage data corrected for changes in social security contribution arrangement.

2/ Q/(Q-4) growth.

3/ The band was widened from +/- 7% to +/- 10% on February 26, 1998, to +/- 12.5% on October 28, 1998, and to +/- 15% on March 24, 1999.

- **Reestablishing the downward momentum in inflation is essential.** Some reversal of the recent sharp drop in food prices relative to nonfood prices may complicate this task, but a prospective drop in oil prices should help. In light of the large current account imbalance, relying solely on monetary policy to secure ambitious disinflation targets is risky, if not futile: higher interest rates are likely in the short run to attract capital inflows, erode competitiveness, and widen current account deficits.

- **In this setting, fiscal consolidation focused on expenditure reform becomes all the more important.** Lower fiscal deficits will reduce the external imbalance, inflationary pressures and the constraint on monetary policy. The next few years will see substantial pressures on spending in connection with EU entry. The task for fiscal policy will be to build on the recent reforms to pensions, health care, and devolution of spending decisions to secure sustainable reductions in the share of social spending in GDP.

- **Unemployment may be boosted by demographic trends, needed reforms in the agricultural sector, and ongoing industrial restructuring.** Job creation will be critical to absorb the large inflow of youth into the labor force and the existing extensive hidden unemployment in the rural areas. Pressures for distortive job creation are likely to grow, even while resistance to removing impediments to job creation persists.

III. Macroeconomic Outlook for 2000 and the Medium term

19. **The macroeconomic framework underlying the 2000 budget as well as staff projections show output growth above 5 percent in 2000**, a modest strengthening of the external current account balance, and a decline in inflation (Table 2). These projections rest on key assessments, notably on export potential, wage behavior, and domestic savings and investment.

20. **The authorities were confident of Poland's export potential in 2000**, despite the reported weakness of U.S. dollar export values for 1999 as a whole. In their view, the latter reflected more rigorous enforcement of coding guidelines for banks reporting BOP transactions from early 1999, the collapse of eastern markets, and the revaluation effect of the depreciation of the Euro vis-à-vis the U.S. dollar, rather than competitiveness or structural problems. The pick-up in exports towards the end of the year supported this view. Staff concurred, noting the absence of anecdotal evidence of major export difficulties and partner countries' trade data which indicate appreciable growth of Polish exports in 1999. In 2000, Poland looks well-placed to take advantage of a projected improvement in eastern markets and the recovery in the EU. With evidence of excess capacity and new capacity coming on stream, the staff expect merchandise export values to grow by some 20 percent in 2000.

21. **After peaking around 10 percent in early 2000, the authorities and staff project that 12–month inflation will fall during 2000** owing to tighter monetary and fiscal policies, the recovery of the zloty from its late 1999 lows, continued high productivity growth, and moderating international energy prices. Administered price increases and some acceleration in the price of food relative to nonfood prices were factored into the projections. There are no signs that nominal wage growth has—or will imminently—pick up in response to the overshoot of the 1999 inflation target. Instead, high unemployment rates, the budgetary commitment to nominal

wage growth in 2000 of 6.7 percent for civil servants and 6.8 percent for other public sector employees, high labor productivity growth and firm macroeconomic policies would contain this risk.

22. **Fiscal consolidation and the rebound in economic activity dominate the outlook for domestic savings and investment in 2000.** Domestic savings should strengthen relative to GDP by about 1½ percentage points, a result of a planned fiscal adjustment relative to GDP of 1½ percentage points, the consequent partial offset in private savings rates, and an increase in corporate savings during the cyclical upswing. Both staff and the authorities project a return to double-digit fixed investment growth rates in 2000: increased corporate savings and higher economic growth rates should more than offset the effects of increased real banking interest rates. On these projections, staff expect the external current account deficit to fall to 6.9 percent of GDP in 2000, at the high end of the authorities' forecast of 6–7 percent of GDP. Uncertainty about the causes of the weak December 1999 current account outturn, however, introduces added risk into this projection.

23. **Looking beyond 2000, the outlook is for sustained high growth associated with sizeable current account deficits.** Consensus estimates of Polish growth range from 5-7 percent, largely reflecting increased labor productivity and continued high investment rates. Markets, the authorities, and the staff all anticipate continued large Polish current account deficits because the gap between private investment and savings will remain large or even grow. Fixed investment will be buoyed by strengthening demand in the EU, prospective EU accession, and continued industry restructuring. Private savings, however, are unlikely to rise much. While rapid economic growth would boost household savings, prospective EU entry, financial sector reform, and improved employment prospects are likely to offset this effect. Corporate savings rates could strengthen further, but are already high by international standards.[6] In this context, the authorities were confident that the prospective current account deficits could be readily financed: FDI inflows boosted by privatization receipts should amount to over half of the projected current account deficits to 2001; thereafter as privatization-related FDI inflows decline, portfolio inflows are likely to take up the slack.

A. Fiscal Policy

24. **The authorities viewed the 1999 fiscal reforms as a major step in improving government efficiency and controlling expenditures, especially on transfers.** Devolution has passed control over a large part of general government expenditure to people directly affected by those decisions. The establishment of public health funds separated buyers and sellers of health services and presaged an internal market in the public health service. In the education sector, control of schools up to the secondary school level was transferred to local governments. The pension reform—which includes a new mandatory private pension pillar—would diversify risks to pension funding across both the labor and capital markets through the use of the dual pay-as-you-go and funded pillars, and promote household management of savings in the long run. The reform largely leaves management of the deficit of the pension system at central level, but implementation has been troubled leading to deficit overruns in 1999. The authorities noted that, once bedded down, the reforms will substantially improve the targeting of government

[6] Chapter VI of the Selected Issues Paper discusses the outlook for private savings.

spending, without loosening effective central control of the general government deficit. Staff warmly welcomed the thrust of these reforms.

25. **In this context, the planned fiscal consolidation in 2000 is the first step towards budget balance in the medium term.** The general government balance is targeted to decline from 3.8 percent of GDP in 1999 to 2.7 percent in 2000. The underlying adjustment on the staff definition is, however, 1½ percentage points of GDP.[7] The authorities project revenue as unchanged at 41.3 percent of GDP, the result of revenue neutral changes to tax policy. The adjustment thus reflects planned spending restraint, notably in the public wage bill and transfers, and lower interest costs. Investment spending is projected to rise relative to GDP. The authorities acknowledged that the planned fiscal adjustment was large, but felt this was needed to strengthen the external current account balance, curb inflation, and make progress towards medium-term fiscal goals. With the economy showing signs of a strong recovery, these considerations took on even greater force.

26. **The authorities stated that the tax reforms to be introduced in 2000 aimed to strengthen Poland's competitiveness, simplify the tax system, shift from direct to indirect taxation, anticipate EU requirements, and indirectly support the adjustment of public spending.** Reduced-rate VAT was extended to previously exempt services, and excises continue to be raised towards EU norms. The rate of corporate income tax (CIT) in 2000 will be cut from 34 to 30 percent, alongside the elimination of investment incentives and the simplification and acceleration of depreciation allowances. The legislation also commits the authorities to reduce the CIT rate according to a fixed schedule to 22 percent in 2004. A parallel reform of the personal income tax (PIT) was vetoed by the President mainly on procedural grounds. Similar measures will be proposed to parliament for implementation from 2001, which will include a commitment to a fixed schedule of reductions in the main tax rates.[8] Taken together, the reforms are expected to be revenue neutral. The authorities emphasized that the precommitments to cuts in direct tax rates signaled the direction of policy to investors and, alongside the fiscal deficit commitments, would provide essential momentum to public expenditure reform. Since decision-makers at all levels would be involved in making expenditure adjustments, the process required the momentum garnered by the fiscal deficit and tax reform commitments to succeed.

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[7] Staff make two adjustments to the official data. First, the impact on the general government deficit of revenue losses arising as people switch pension contributions out of the government run PAYG pension system to the mandatory private second pension pillar are excluded because these do not affect domestic savings. Second, transfers to compensate households for past inflation, which are excluded from the budget, are added to spending.

[8] Chapter II of the Selected Issues paper describes and assesses recent tax reforms and outlines the tax reform agenda for the future.

General Government—Budget and Official Projections
(In percent of GDP)

	Budget 1999	Proj. 1999	Proj. 2000
Balance (commitment basis)	**-2.3**	**- 3.8**	**- 2.7**
o/w state budget	-2.0	- 2.4	- 2.3
other general government	-0.3	- 1.4	- 0.5
Balance adjusted for: [1/]	**-1.7**	**- 3.3**	**- 1.7**
Effect of pension switching	0.5	0.5	1.5
Compensation payments	0.0	0.0	- 0.5
Adjusted revenue	**41.6**	**41.2**	**41.3**
Adjusted expenditure	**43.3**	**44.4**	**43.1**

1/ See footnote 7 for explanations of the adjustments.

27. **Staff welcomed the 2000 budget and the tax reform proposals.** The targeted adjustment was appropriate and the macroeconomic assumptions underlying the estimates were rightly cautious. Confidence in the estimates was bolstered by the history of firm execution of spending ceilings in the state (central government) budget. Nevertheless, with the new fiscal systems operating in largely uncharted waters, the risks of expenditure overruns outside the state budget seemed substantial: it was not clear whether problems in 1999 with revenue collections in the FUS had been eliminated; although local governments are believed to have compressed spending in 1999, only partial data exist; and even if the assumptions for 1999 are correct, the staff wondered whether compression of local government spending would continue, as had been assumed in the projections.

28. **The authorities noted that several steps had been taken to minimize the risks of slippages in the new fiscal systems.** On ZUS (Social Security Administration), management had been changed and strengthened in mid–1999, data collection problems were being addressed (although this process would be slow), and the "one month" revenue loss would not be repeated. ZUS had also requested IMF technical assistance on data collection issues. On local governments, the authorities were confident that conservative financial behavior would continue, but a review of financial discipline measures was scheduled for 2000. The staff noted that tax and customs administration were still weakened by longstanding difficulties which could compromise the revenue targets, and retained concerns about deficit slippages outside the state budget. But staff noted that the conservative forecasts for state revenue and spending allayed fears that the adjustment for the general government would be substantially less than targeted. Staff underscored that if significant slippages emerged and the external current account shows no sign of stabilizing, it would be critical to take prompt corrective action, especially if inflation were also above target.

29. **For the medium–term, the authorities are committed to eliminate the deficit in general government to make room for private investment without straining the current account position.** The commitment helped to clarify fiscal prospects and support investor confidence.[9] But the authorities underscored that if pressures on the current account did not subside, greater fiscal adjustment could be necessary. In light of the balanced budget target and the parallel commitment to reform taxes in a revenue neutral manner, staff projections suggest that current non-interest spending would need to fall from 38½ percent in 1997–99 to 35¾ percent in 2001-03.[10] The authorities stated that expenditure restraint was central to their plans and that the high level of social spending made it a prime focus. The 1999 reforms were a first step in this process.

Poland: General Government Finance, 1999-2003
(In percent of GDP)

	1999	2000	2001	2002	2003
Revenue	41.3	41.7	41.3	41.6	41.2
Expenditure	45.0	44.8	43.5	43.1	42.1
Primary current expenditure	38.2	38.0	36.9	36.1	34.4
Interest payments	3.4	2.8	2.5	2.3	2.1
Capital expenditure	3.5	4.0	4.1	4.7	5.6
Balance	-3.8	-3.1	-2.2	-1.5	-0.9
Public sector debt	39.9	36.5	33.6	31.2	29.3

30. **Staff welcomed the commitment to a balanced budget.** They cautioned, however, that if the deficit targets were to be adhered to without resort to higher tax rates, early steps would be necessary to identify and secure savings by the central and local governments. In this regard, staff expressed concerns about the fiscal discipline on local governments where, in the context of significantly expanded spending responsibilities, current legal ceilings on borrowing were quite high. Though credit constraints now limited their scope to borrow these constraints were easing. Staff suggested that action be taken immediately before problems began: for example, limits on borrowing might be lowered and then gradually increased to current levels, central government transfers to local governments could be reduced when the latter borrowed excessively, and higher capital requirements could be applied on bank lending to local as opposed to central government. The authorities agreed to examine these suggestions in the imminent review of local government financing arrangements. Staff also suggested that some flexibility in the targets might be necessary to accommodate automatic stabilizers and that more publicity could be given to the commitments until they were firmly understood by the general public.

31. **The authorities noted the difficulties some commentators had voiced during 1999 with the transparency of fiscal data.** In particular, concerns had been raised with the reporting of transactions between the central and other levels of government. The authorities were eager to

[9] Chapter I of the Selected Issues paper assesses the content and flexibility of medium-term commitments on the fiscal balance.

[10] Chapter III of the Selected Issues paper assesses the expenditure reforms necessary to reconcile the commitments on the fiscal balance and on taxation.

address all such concerns and requested IMF assistance in completing a fiscal transparency assessment during 2000. Staff supported the request and suggested that meanwhile some concerns could be mitigated if official commentary on the budget focused on the general government rather than the state budget balance. This would be consistent with devolution and would reinforce to the public that the macroeconomic effect of policies must be judged by the impact on the general government balance. Also, the collection and dissemination of data on operations of local government and on the newly devolved public health facilities should be accelerated.

B. Monetary and Exchange Regime Policies

32. **Inflation is targeted to fall to the range of 5.4–6.8 percent by December 2000.** The 1999 target having been overshot, the monetary authorities placed a high premium on meeting the 2000 target. In their view, an increase in official interest rates in late 1999 had been necessary for several reasons: headline inflation was substantially above the target and rising; the influence of special factors—rising oil prices and low food price increases—largely cancelled each other out; domestic demand was growing strongly and was being fed by an increase in household credit of some 50 percent; and given the lags in the effect of monetary policy on inflation the window for action to affect the 2000 target was closing. Because banking interest rates have been slow to respond to changes in official rates, a large adjustment that would force an early response and obviate the need for further small increases later was deemed desirable.

33. **Reaction to the increase has been positive**. Banking interest rates rose approximately in line with official interest rates, and the yields on medium-to-long term government paper dropped following the action, signaling a renewed confidence in the prospects for disinflation in the medium term. The MPC was confident the action had been sufficient to meet the 2000 target and ensure progress toward the medium term target. Nevertheless, fiscal, trade, and agricultural policy actions could still exert a substantial influence on the 2000 inflation outturn. The MPC was therefore actively publicizing the implications of decisions in these areas for inflation. Staff agreed that the inflation target was within reach given anticipated economy-wide labor productivity growth and nominal wage growth of 5 and 11 percent respectively. But much would depend on how nominal wages would respond to recently increased inflation. Thus, it was critical that public sector wage policy and decisions on import tariffs and agricultural price support should buttress the disinflationary effort.

34. **The MPC was not concerned about potential conflicts between the recent or any possible future increases in interest rates and avoiding pressure on the external current account.** The MPC emphasized that it had been formally charged to target inflation. Even if monetary policy played a part in determining the real exchange rate and the current account imbalance in the short run, fiscal policy had a larger effect on the underlying savings and investment decisions. Staff, while agreeing on the primacy of the focus on inflation, emphasized that in an environment of large fiscal and current account deficits decisions on interest rates had to take into account effects of capital flows, the exchange rate and ultimately the current account. Thus, in the near term, when inflation is likely to remain at current levels or even to rise further, any consideration of a further increase in interest rates would have to be weighed carefully against the likely effect on the current account.

35. **The monetary authorities target inflation below 4 percent in 2003.** This will complete Poland's progressive disinflation process and set the stage for eventual entry into EMU. In pursuit of this objective, the inflation targeting framework for monetary policy was being strengthened. From 2000, inflation reports would be published on a quarterly basis rather than annually, and research on inflation was being extended. Staff agreed that the inflation target was appropriate and consistent with inflation rates in partner countries while allowing scope for Balassa-Samuelson effects.

36. **Staff discussed additional steps to strengthen the inflation targeting apparatus.** Specifying the inflation target range for each year until 2003, rather than only one year ahead would help convey the authorities' intentions to markets. To avoid the complete reconstitution of the MPC when all the current members' terms expire in 2004, members' terms in office should be made to overlap and provision should be made for reappointments. And staff agreed with the authorities that completion of bank privatization is necessary to ensure full effectiveness of the transmission of official to banking interest rates. The authorities felt that the medium term inflation target provided a clear anchor for medium-term inflation expectations, though a path to that goal could strengthen it further. The step reconstitution of the MPC was undesirable but it is enshrined in law which would be difficult to change.

37. **Abolition of the exchange rate band remained under active review.** [11] The monetary authorities favored abolition of the band to establish the "purity" of the inflation targeting regime. For the most part, they were not persuaded that the band was a bulwark against excess appreciation of the zloty. Staff suggested that the band was so wide that possible conflicts with the inflation target seemed unlikely, but agreed that the role of the band in capping appreciation pressures was probably small. The band may play a residual role in guiding market assessments of the appropriate value for the zloty and in guiding inflation expectations, though neither of these arguments for retaining the band was overwhelming.

38. **The authorities decided, subsequent to the mission, to delay the abolition of the remaining controls on capital flows.** These controls require prior NBP approval of non-bank short-term capital flows and were scheduled for abolition at end-1999 under a 1996 agreement with the OECD. The authorities were concerned that the scheduled timing was inappropriate: they expected the removal of controls to appreciate the zloty and to generate higher capital inflows, higher external debt, and greater vulnerability. They had examined the possibility of price-based controls on short term capital flows and concluded that these would be ineffective in Poland. Staff argued that the sizeable offshore spot and forward markets in the zloty alongside unfettered access for residents to foreign currency deposits and credits from domestic banks meant that the remaining exchange controls did not constitute much of an impediment to speculative pressures on the zloty or the accumulation of foreign debt. Abolition would, however, promote the development of domestic financial markets, improve monitoring of foreign exchange transactions, and facilitate hedging. While abolition should be postponed until

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[11] An assessment of exchange rate regimes appropriate for EU-accessant transition countries can be found in Exchange Rate Regimes in Selected Advanced Transition Economies: Coping with Transition, Capital Inflows and Preparing for EU Accession (forthcoming Board paper).

possible Y2K problems had been resolved and the current account balance had declined sustainably below 7 percent of GDP, further delays seemed unwarranted.

39. **The NBP intended to continue to refrain from intervention in foreign exchange markets—a position staff strongly supported.** Following elimination of the daily exchange rate "fixing" in mid-1999, the NBP had only sold foreign exchange to the government to cover its foreign debt servicing obligations. The exchange rate otherwise floated freely. Staff agreed with the authorities that the volatility of the exchange rate, even over the past year, had not been excessive but had promoted responsible hedging. To preserve the principle of non-intervention, staff suggested sales of foreign exchange to cover government debt service should be matched by purchases in the market. The authorities were concerned that privatization receipts if not fully sterilized could distort the foreign exchange market. Accordingly, plans were being made to put some receipts from non-residents in a special account in the NBP to be held against future debt service. Staff suggested that large privatization receipts had been absorbed during 1999 without evidence of a distorting effect on the foreign exchange market. If, however, the special account were activated, it should be managed according to strictly defined rules that would eliminate the risk that the account would be used even implicitly to manipulate the exchange rate.

40. **While the large current account deficit is a source of vulnerability, staff agreed that other key indicators put Poland at the safest end of the spectrum (Table 6).** Current gross reserves covered seven months of imports and 400 percent of short-term debt. This level struck an appropriate balance between the cost of holding reserves and the need to provide investors with a signal of financial strength. Alongside Poland's robust performance on other indicators of vulnerability, including the ratio of reserves to broad money and external debt, the authorities saw no need to participate in the CCL (Table 6).

41. **Banking and financial sector supervision was being continually strengthened.** The banks remained well capitalized, on average reporting capital of 16 percent of risk-weighted assets. In mid-1999, 60 percent of equity in banks was foreign owned. The banks had been little exposed to Russia in 1998 and had weathered recent exchange rate and interest rate shocks well. Regulators were alert to prudential risks that could emanate from rapid growth of credit to households, but no signs of strain were yet apparent. Vulnerabilities have been examined with Fund staff on several occasions, including during the 1998 Article IV Consultation, and on each occasion the assessment was favorable. But staff underscored that the challenges arising from possible large capital inflows and the development of the non-bank financial sector spawned by the recent three-pillar pension reform meant that Poland could gain from a full Financial Sector Stability Assessment. The authorities agreed to consider this proposal.

C. Structural Policies

42. **The authorities stressed their commitment to rapid completion of industrial restructuring and privatization**. Not only was this essential to the continued dynamism of the economy, but it had now become part of the preparation for EU accession. The government's objective is to privatize more than 70 percent of the total value of its current assets by 2002. State ownership would be limited to mostly minority stakes in strategic sectors, including defense, energy, transportation, and postal services, where veto power in key decisions was still considered desirable, even if rarely used. The program for the coal sector, which aims for

significant reductions in production capacity, employment and ultimate privatization remained on track. Mine closures and redundancies exceeded expectations in 1999, but declining international coal prices had worsened the financial position of the industry. Key projects anticipated for 2000 and 2001 include further sales in telecommunications and financial services, as well as privatization of various companies in the energy sector. The authorities also hope to complete the privatization of the steel sector by 2001, which together with the other restructuring-intensive industries (namely coal and defense) presents the largest burden for the budget and the economy as a whole. Consequently, privatization of these industries is regarded by the government as crucial, although receipts are unlikely to be sizeable.

43. **The authorities emphasized the importance of job creation** to ameliorate the social costs of the restructuring and absorb the large inflow of new entrants to the labor force.[12] After some employment growth in earlier years, the decline in employment in 1999 reflected the economic slowdown. But even once the cyclical decline was reversed, the unemployment rate was unlikely to fall rapidly owing to expected labor force growth in 2000–2005 of ¾ percent a year and the need eventually to absorb hidden unemployment in the agricultural sector, equal to about 4–5 percent of the total labor force. Continued rapid growth of the private sector, together with flexible labor market structures are central to employment creation. In the spirit of increasing labor market flexibility, the authorities plan to reform the minimum wage in two ways: to index it to inflation rather than average wages so as to reduce it relative to average wages over time; and to introduce a lower minimum for labor market entrants. Regional differentiation of minimum wages, though desirable, was not permissible under the constitution. Staff welcomed the initiatives, noting that at some 40 percent of average wages, the minimum wage was well above that in other countries in the region. The authorities noted several points of pressure for direct interventions—including a shorter work week, public works, import protection and export subsidies. They were resisting these although some would undoubtedly be successful. The goal was to keep such schemes as benign as possible. Staff agreed that direct interventions introduced distortions, had limited beneficial impact on employment even in the short run, and were often costly to the budget. Staff agreed that trade liberalization, increased flexibility of labor market structures including the work week, and continued simplification of tax structures should all feature prominently in the overall jobs strategy.

44. **Poland's trade policy centers on progressive liberalization, but recent decisions to increase tariffs on agricultural products have interrupted this trend.** Trade policy is framed by WTO membership and free trade agreements with the EU and other Central European countries under the Central European Free Trade Agreement (CEFTA). Accordingly, the effective tariff rate fell from 4.2 percent in 1998 to 3.4 percent in 1999, due to tariff reductions on industrial goods. Overall effective protection on agricultural products was essentially unchanged in 1999, with increases in rates on certain products to the WTO ceilings and the withdrawal of some preferences offset by reductions in other tariffs. A similar pattern will occur in 2000 for agricultural products. The staff welcomed continued trade liberalization, and cautioned against further tariff increases because they would be distortionary, inflationary, and run counter to Poland's long standing commitment to liberalization.

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[12] Chapter V of the Selected Economic Issues paper discusses issues in the labor market.

IV. Staff Appraisal

45. **In the decade since Poland embarked on transition**, economic growth has been strong, inflation has been substantially, if gradually, lowered, and the structure of the economy—including the financial sector, company ownership, international trade, and capital account arrangements—has seen a sea-change. This record puts Poland amongst the leaders in transition and EU accession, though much remains to be done, notably in agricultural and industrial restructuring and in privatization.

46. **The task in the next decade will be securing Poland's place among industrial countries, in particular through early EU accession.** Polish policymakers are focussed on ensuring smooth and early progress toward membership in the EU, and this is providing considerable momentum to policy reforms and to market confidence in Poland. However, jolts along the way are likely as markets reassess the progress of negotiations on EU entry, the conditions that will have to be met and the fiscal costs.

47. **Macroeconomic policy must contribute to this process by ensuring stable conditions that promote the well-established dynamism of the private sector.** The first priority is to halt the trend increase in the current account deficit. Further increases in that deficit would make Poland unduly vulnerable to changes in market sentiment. Putting inflation back on a downward track is a close second in policy priorities. Looking further ahead, ensuring rapid growth and flexible labor market structures will be key to addressing high unemployment.

48. **Stabilizing the current account balance and sustaining disinflation in 2000 requires increased public savings.** At 3.8 percent of GDP in 1999, the fiscal deficit is too large and curbing it in 2000 will be critical to containing domestic demand, imports and inflation. The targeted adjustment in 2000—1 ½ percentage points of GDP—is large but appropriate given the strength of the recovery and the urgency of stabilizing the current account deficit. There are, however, risks of slippage outside the state budget, notably in the social security system, local governments and the newly created health funds. Should these materialize, the general government deficit target should be defended through midyear measures, particularly if the current account balance has not stabilized. Throughout the year, the authorities should focus public attention on the general (rather than state) government balance and accelerate dissemination of data on local governments as part of its commitment to fiscal transparency. An IMF fiscal transparency assessment will provide an occasion to consider further steps.

49. **For the medium term, when current account pressures are likely to remain an issue, the government's commitment to balancing the budget is appropriate.** The more widely perceived is this commitment, the stronger will be its effect on investor confidence. Equally important are the government's goals for improving the tax structure and cutting spending ratios. The recent and pending tax reforms—which will simplify the taxation of business and households—will enhance the dynamism of the private sector. Given the commitments to further cuts in the tax rates, public spending restraint will be essential to secure the deficit targets. The major structural changes—devolution, and pension and healthcare reform—initiated in 1999 should provide the foundation for improving the efficiency of government operations while containing costs. The effectiveness of these changes, however, will depend on addressing the

problems that arose in the first year of implementation, organizing better collection of sub-government level data, and introducing disciplining devices for local governments.

50. **The inflation targets of 5.4–6.8 percent in 2000 and below 4 percent by 2003 are ambitious but achievable.** For 2000, lower international energy prices and the planned fiscal adjustment will help. But also, public sector wages will need to adhere to the 2000 budget guidelines, and efforts made to head off the risk that the current increase in inflation feeds into private wage settlements. The recent large increases in official interest rates will substantially contribute to these efforts. For the medium term, announcing a target path toward the 2003 inflation target would strengthen the anchor for expectations.

51. **Poland's large external current account deficit impedes the effective operation of inflation targeting.** The vulnerabilities associated with high deficits imply that monetary policymakers should not ignore the consequences of their actions for the external balance. In the near term, any consideration of a further increase in interest rates in response to rising inflation would have to be weighed against the likely effect on the exchange rate and current account. This underscores the importance of the planned fiscal adjustment both for meeting the immediate inflation goal and for strengthening the scope for monetary policy adjustments over the medium term.

52. **The intention to continue to abstain from intervention in the foreign exchange market is a strong reaffirmation of a system that has served Poland well.** The volatility of the exchange rate has been manageable and has promoted responsible hedging. The proposal to place some privatization receipts into a special account in the central bank is intended to minimize the impact of those flows on the foreign exchange market. There is little evidence that these flows have in the past had a marked impact on the market, but if the account is established, it should be managed so as to preserve the principle of non-intervention.

53. **Two changes to the exchange system—abolition of the crawling parity with its ±15 percent band and elimination of residual controls on short term capital movements—are under discussion.** The band, which at best provides a weak signal to guide the value of the zloty, neither substantially hinders nor helps inflation targeting over the likely range of exchange market developments. Owing to possible market jitters at the time of abolition, the step should be delayed until the current account deficit has fallen convincingly from its current high level. Capital account liberalization, on the other hand, should be beneficial. Because remaining controls are applied flexibly, there are sizable on- and off-shore zloty markets, and short-term transactions for banks are already free, eliminating the controls should not have significant sustained effects on the value of the zloty. It should, however, promote financial market development, improve monitoring and increase hedging opportunities. It seems reasonable, however, also to delay this step until the current account has stabilized.

54. **Banking supervision is satisfactory.** The pressures to which it is subject could increase, however, if the prospect of EU accession unduly lowered investors' risk assessment. The evolution of the pension industry spawned by the recent pension reform also underscores the need to be vigilant against risks. To this end, a Financial Sector Stability Assessment is strongly recommended for 2000.

55. **Job creation is paramount.** With registered unemployment back at 13 percent, sizeable hidden unemployment, a growing labor force, and prospective—and much needed—agricultural reforms and further industrial restructuring, removing impediments to job creation is essential. Reform of the minimum wage—at a regionally high 40 percent of average wages—is a priority in this effort. The authorities are right to resist direct interventions such as reductions in the work week, import protection, and export subsidies. Poland's strength, not only for employment growth but for the overall health of the economy, lies in the vigor of its private sector and the strength of transparent market mechanisms.

56. Poland's statistical base is adequate for surveillance. The staff urges the authorities to continue to improve the quality of macroeconomic data, in particular balance of payments data and the transparency of fiscal data. Poland has subscribed to the Special Data Dissemination Standard and its metadata are posted on the Data Standards Bulletin.

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

Table 1. Poland: Main Economic Indicators

	1995	1996	1997	1998 Prel.	1999 Staff Est.	2000 Staff Proj.
Real economy (change in percent)						
Real GDP	7.0	6.0	6.8	4.8	4.1	5.2
Real domestic demand	4.5	12.2	9.4	6.5	4.9	5.5
Of which: Private consumption	3.3	8.3	6.9	4.7	5.0	5.1
Gross fixed investment	16.5	19.7	21.7	14.2	6.9	10.4
Exports (real) 1/	22.8	12.0	12.2	11.0	-0.5	12.0
Imports (real) 1/	24.2	28.0	21.4	15.8	2.6	11.8
CPI (end year)	21.6	18.5	13.2	8.6	9.8	6.7
Average gross remuneration (manufacturing)	32.7	26.8	21.9	14.4	11.7	11.1
Registered unemployment (in percent) 2/	14.9	13.2	10.3	10.4	13.0	11.7
General government (percent of GDP) 3/						
Balance (excl. privatization receipts)	-3.1	-3.4	-3.1	-3.2	-3.8	-3.1
Primary balance 4/	1.3	0.1	0.4	0.0	-0.7	-0.3
Public debt	52.5	46.5	43.8	40.1	39.9	36.5
Money (end of year, percent change)						
M2	34.8	31.2	29.1	25.2	19.4	...
Credit to non-government	35.4	44.3	33.6	27.9	27.0	...
Interest rate (90-day t-bill, year average)	25.6	20.3	21.6	19.1	13.6	14.3
Real	-1.8	0.3	5.8	6.5	5.9	5.8
Gross national saving (percent of GDP) 5/	24.0	21.0	21.7	22.0	19.9	21.4
Gross domestic investment (percent of GDP)	19.8	22.0	24.7	26.4	27.4	28.3
Balance of payments						
Current account (percent of GDP)	4.2	-1.0	-3.0	-4.4	-7.6	-6.9
Reserves in convertible currencies (In months of merchandise imports)	7.2	6.6	6.4	7.5	7.5	6.5
Exchange rate (annual average)						
Exchange regime				Crawling Band 6/		
Nominal effective rate (1990=100)	56.1	48.1	44.7	43.0	39.1	...
CPI Real effective rate (1990=100)	120.6	130.7	133.1	140.6	135.7	...
Fund Relations (on December 31, 1999)						
Quota (SDR million)					1369.0	
Use of Fund Resources					0.0	
Fund holding of currency (in percent of quota)					87.4	
Holdings of SDRs (in SDR millions)					8.1	
Memorandum items:						
Risk-weighted capital adequacy ratio	18.0	16.1	16.9	...	...	...
M2 to reserves	2.8	2.6	2.4	2.3	2.5	...

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

1/ National accounts basis.

2/ End of period.

3/ Consists of the central budget, social security funds, extra-budgetary funds, and local governments.

4/ This excludes net interest payments from the government balance.

5/ These estimates equate the current account balance with foreign dissavings, and differ in this regard from the authorities' estimates.

6/ The zloty currently floats within a ± 15 percent band around the central rate, which depreciates at a fixed monthly rate (0.3 percent since March 24, 1999) against a basket of currencies.

Table 2. Poland: National Accounts and Medium Term Framework

	1997	1998 Prel.	1999 Est.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.
National accounts	(Percentage change at constant prices)							
GDP (at market prices)	6.8	4.8	4.1	5.2	5.5	5.6	5.6	5.6
In billions of zlotys	469	549	612	694	777	861	947	1039
Gross domestic final expenditure	9.4	6.5	5.0	6.0	5.0	5.2	5.2	5.2
Private consumption	6.9	4.7	5.0	5.1	4.6	4.7	4.5	4.3
General government consumption	3.2	1.6	1.4	1.8	1.6	1.4	1.2	0.4
Fixed investment	21.7	14.2	6.9	10.4	8.2	8.0	8.9	9.6
Savings and investment balances	(Percent of GDP)							
Total investment	24.7	26.4	27.4	28.3	29.1	29.8	30.7	31.8
Fixed investment	23.6	25.3	26.5	27.8	28.5	29.2	30.1	31.2
Corporations	19.4	21.1	22.4	23.3	24.0	24.2	24.5	25.6
General government	4.2	4.3	4.1	4.5	4.5	5.0	5.6	5.6
Inventories	1.1	1.1	0.9	0.5	0.6	0.6	0.6	0.6
Total savings	24.7	26.4	27.4	28.3	29.1	29.8	30.7	31.8
Foreign savings	3.0	4.4	7.6	6.9	6.6	6.3	6.0	5.5
Domestic savings	21.7	22.0	19.9	21.4	22.5	23.5	24.7	26.3
General government savings	0.0	0.0	-0.3	0.5	1.5	2.8	4.2	5.2
Private savings	21.7	22.0	20.2	20.9	21.0	20.7	20.5	21.2
Savings through 2nd pillar	...	...	0.5	1.5	1.7	1.7	1.7	1.7
General government	(Percent of GDP. Commitment basis, excl. privatization receipts)							
Total revenue	43.0	41.7	41.3	41.7	41.3	41.6	41.2	41.2
Total expenditure	46.1	44.9	45.0	44.8	43.5	43.1	42.1	41.2
Balance	-3.1	-3.2	-3.8	-3.1	-2.2	-1.5	-0.9	0.0
Balance excluding 2nd pillar	-3.1	-3.2	-3.3	-1.6	-0.5	0.2	0.7	1.7
Debt	43.8	40.1	39.9	36.5	33.6	31.2	29.3	26.7
Prices and the labor market								
3-month T-Bill rate (in percent)	21.6	19.1	13.6	14.3	12.6	11.3	10.6	10.3
	(Percentage change, period average)							
GDP deflator	14.0	11.8	6.9	7.8	6.2	4.9	4.2	3.9
Consumer prices index	14.9	11.8	7.3	8.0	6.3	5.0	4.3	4.0
Real effective exchange rate	1.8	5.6	-3.5	...	...	...	...	...
Manufacturing								
Average gross remuneration	21.9	14.4	11.7	11.1	9.9	8.6	7.9	7.6
Productivity	14.7	7.0	5.0	5.0	5.0	5.0	5.0	5.0
Unit labor costs	6.2	7.0	6.4	5.8	4.7	3.4	2.7	2.4
Registered unemployment (in percent) 1/	10.3	10.4	13.0	11.7	11.3	10.9	10.7	10.5

Sources: National authorities; and Fund staff estimates.

1/ End of period.

Table 3. Poland: Balance of Payments

	1997	1998 Prel.	1999 Est.	2000 Proj.	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.
	(Billions of U.S. dollars)							
Current Account Balance	-4.3	-6.9	-11.7	-11.4	-12.0	-12.7	-13.3	-13.4
Merchandise trade balance	-11.3	-13.7	-14.5	-15.2	-16.0	-16.7	-18.1	-19.5
Exports 1/	27.2	30.1	26.4	31.5	36.0	40.2	44.8	50.0
percentage change in price	-8.5	4.4	-2.7	1.4	2.9	1.0	1.0	1.0
percentage volume growth	13.7	9.4	-10.0	17.7	11.2	10.4	10.5	10.4
Export market growth	8.5	3.7	3.5	7.7	6.1	5.9	5.7	5.6
Imports 1/	38.5	43.8	40.8	46.7	52.0	56.9	62.9	69.5
percentage change in price	-8.4	3.9	-2.8	2.0	2.9	1.1	1.6	1.6
percentage volume growth	22.0	14.6	-4.1	12.0	8.4	8.2	8.8	8.7
Growth of domestic demand	9.4	6.5	4.9	5.5	5.1	5.2	5.2	5.2
Services balance	0.3	-0.5	-1.6	-1.6	-1.9	-2.3	-2.7	-3.1
Exports	3.7	3.7	3.3	3.6	3.9	4.2	4.5	4.8
Imports	3.4	4.2	4.9	5.2	5.9	6.5	7.2	7.9
Net income	-0.5	-0.6	-0.8	-0.6	-0.6	-0.6	-0.7	-0.7
Net transfers	1.2	1.9	1.6	2.1	2.3	2.8	3.8	5.5
Net unclassified current transations	6.0	6.0	3.6	3.9	4.2	4.2	4.4	4.4
Capital account, net	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial account, net	5.3	10.7	9.2	11.1	14.1	13.9	15.3	14.8
Net direct investment	3.0	5.0	6.6	7.9	7.4	5.4	4.7	5.1
by non-residents	3.1	5.1	6.8	8.2	7.8	5.9	5.3	5.8
o/w privatization	2.0	2.0	3.4	4.8	3.5	1.2	0.0	0.0
other	1.1	3.1	3.4	3.4	4.3	4.8	5.3	5.8
by residents	0.0	-0.2	-0.1	-0.3	-0.4	-0.5	-0.6	-0.7
Portfolio investment	2.1	1.3	1.1	1.8	3.2	4.0	4.5	4.7
Other	0.2	4.4	1.4	1.4	3.6	4.4	6.1	5.0
Errors and omissions	2.5	1.8	2.3	0.0	0.0	0.0	0.0	0.0
Overall balance	3.6	5.7	-0.2	-0.2	2.1	1.2	2.0	1.4
Net reserves of the NBP	-3.6	-5.7	0.2	0.3	-2.1	-1.2	-1.9	-1.4
Net credit from the IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo items: end of period								
Gross reserves of the NBP	20.7	27.4	25.5	25.2	27.3	28.5	30.4	31.9
in months of merchandise imports	6.4	7.5	7.5	6.5	6.3	6.0	5.8	5.5
Net reserves of the NBP (incl IMF)	20.6	27.4	25.5	25.2	27.3	28.5	30.4	31.9
Foreign debt in convertible currency	48.9	56.9	60.9	63.5	69.1	76.0	85.0	92.9
in percent of GDP	34.2	36.2	39.5	38.6	37.9	37.7	38.3	38.2
Short-term foreign debt	5.1	5.6	5.9	6.1	6.6	7.1	7.9	8.5
Use of IMF credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest payments 2/	1.3	2.0	2.9	3.0	3.3	3.6	4.1	4.5
Amortization 2/	0.7	1.5	2.1	3.8	5.1	6.9	8.5	9.3
Debt Service, percent of exports of G&S 2/	6.6	10.4	16.8	19.6	21.0	23.7	25.4	25.0
Gross funding requirement 3/	8.6	14.1	13.5	14.9	19.2	20.7	23.7	24.1
Identified debt creating flows (net)	1.7	2.8	4.0	2.6	5.6	7.0	8.9	7.9
GDP in US$ billion	143.1	157.2	154.1	164.5	182.3	201.8	221.8	242.8
GDP per capita US$	3702.3	4065.9	3975.3	4234.6	4688.2	5187.5	5698.0	6236.5

Sources: National authorities; and Fund staff estimates.

1/ Projected nominal goods trade values for 1998 include staff adjustments for underrecording in the official settlements data.

2/ On medium- and long-term debt.

3/ The sum of the current account deficit, amortization, and the change in reserves.

Table 4. Poland: Monetary Survey, 1994-99
(In billions of zlotys)

	1994	1995	1996	1997	1998	1999Q1	1999Q2	1999Q3	1999Q4
Net International Reserves	27.5	50.4	62.3	82.8	96.3	106.3	99.5	109.8	110.7
(in billions of U.S. dollars)	11.3	20.4	21.7	24.4	28.0	27.6	25.2	26.9	26.7
Net domestic assets	49.8	53.8	74.4	93.6	124.5	124.0	136.7	136.2	152.8
Credit to nongovernment	41.5	56.2	81.1	108.3	138.5	148.6	155.8	167.4	175.9
Credit to government, net	40.5	41.8	48.2	55.3	61.3	63.9	65.2	61.6	64.7
Other items, net	-32.5	-44.2	-75.2	-70.0	-75.2	-88.5	-84.3	-92.8	-87.8
Money and quasi money 1/	77.3	104.2	136.7	176.4	220.8	230.3	236.2	246.0	263.5
Zloty money	55.2	111.5	113.3	145.6	187.1	193.2	193.2	207.5	223.8
Foreign currency deposits	22.1	21.3	23.4	30.8	33.6	37.1	37.1	38.5	39.7
Memorandum items (in percent)									
Broad money growth (12-month)	36.4	34.8	31.2	29.1	25.2	27.6	22.9	20.9	19.3
Real broad money growth (12-month)	6.8	10.9	9.3	14.0	15.2	20.2	15.4	11.9	8.7
Real growth of credit to nongovernment	-3.5	11.2	20.3	18.0	17.8	21.9	19.8	18.3	15.7
Share of foreign currency deposits in broad money	28.5	20.4	17.1	17.5	15.2	16.1	15.7	15.6	15.1

Sources: National Bank of Poland, and Fund estimates and projections.
1/ There was a break in this series at the end of 1996.

Table 5. Poland: State and General Government Summary, 1994-2000 1/

	Actual 1994	Actual 1995	Actual 1996	Actual 1997	Actual 1998	Budget 1999	Government projections 1999	Staff projections 1999	Government amended budget 2000	Staff projections 2000
					(in billions of zlotys)					
State revenue	61.5	81.1	95.9	113.2	126.5	129.3	125.9	126.5	140.8	146.1
Taxes	56.5	74.8	90.4	105.7	120.0	123.2	118.3	118.3	131.6	134.7
Direct taxes	24.2	32.3	36.9	43.1	49.5	39.3	38.1	38.1	39.4	40.3
Personal income tax 2/	17.4	23.5	26.2	29.8	34.7	23.0	23.1	23.1	25.2	26.1
Enterprise income tax	6.8	8.8	10.7	13.3	14.8	16.3	15.0	15.0	14.1	14.1
Indirect taxes	24.3	33.0	43.9	55.3	64.4	77.9	74.6	74.6	87.6	89.5
VAT/Turnover	15.0	20.7	28.0	36.3	42.8	52.0	49.6	49.6	57.5	58.8
Excises and other	9.3	12.3	15.8	19.0	21.6	25.9	25.0	25.0	30.1	30.8
International taxes	7.5	9.0	9.4	7.1	6.1	6.0	5.6	5.6	4.6	4.9
Custom duties	4.9	5.8	6.5	7.1	6.1	6.0	5.6	5.6	4.6	4.9
Import surcharge	2.6	3.3	2.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other taxes	0.5	0.3	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Non-tax revenue	5.0	6.3	5.6	7.5	6.5	6.2	7.6	8.2	9.2	11.4
Central bank transfers	2.4	3.0	0.4	1.1	0.3	0.4	0.5	0.5	2.4	2.4
Other	2.6	3.3	5.2	6.4	6.2	5.8	7.1	7.7	6.8	9.0
o/w EU Grants 3/	...	...	...	...	...	0.0	0.0	0.6	0.0	2.2
State expenditure	68.9	91.2	108.8	125.6	139.7	141.9	138.5	139.1	156.1	163.0
Goods and services	28.0	36.8	44.5	51.7	57.7	32.1	31.4	31.4	32.9	33.3
Subsidies and transfers	28.4	35.6	44.9	51.7	55.4	81.6	81.1	81.1	95.7	100.0
Interest	8.8	14.0	14.4	16.3	17.9	20.7	18.8	18.8	19.1	19.1
Capital and net lending	3.7	4.8	5.0	5.9	8.7	7.5	7.2	7.8	8.4	10.6
Compensation payments included in transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.3
State balance (cash): MoF	-7.4	-10.1	-12.9	-12.5	-13.2	-12.6	-12.6	-12.6	-15.3	-16.9
Net change in arrears	0.2	1.2	0.8	0.0	3.6	0.0	2.0	2.0	0.0	0.0
State balance (commitments)	-7.6	-11.3	-13.7	-12.5	-16.8	-12.7	-14.6	-14.6	-15.3	-16.9
Rest of general government	0.8	1.9	0.8	-2.1	-1.0	-1.6	-8.6	-8.6	-3.4	-4.3
General gov't balance (comm.)	-6.8	-9.4	-12.9	-14.5	-17.8	-14.3	-23.2	-23.2	-18.7	-21.2
Financing	6.8	9.4	12.9	14.5	17.8	14.3	23.2	23.2	18.7	21.2
Domestic	7.8	7.3	12.8	12.5	17.5	14.3	22.5	22.5	20.7	23.2
Bank 4/	4.2	-0.9	2.7	1.1	-1.2	0.6	6.4	6.2	3.0	2.1
Non-bank	2.0	5.6	6.4	4.9	11.6	6.8	7.6	7.8	9.4	9.4
Privatization proceeds	1.6	2.6	3.8	6.5	7.1	6.9	13.4	13.4	20.1	20.1
Negative net lending and other domestic 5/	0.0	0.0	0.0	0.0	0.0	0.0	-4.9	-4.9	-11.8	-8.4
Foreign	-1.2	0.9	-0.7	2.0	-3.3	0.0	-1.3	-1.3	-2.0	-2.0
Change in arrears	0.2	1.2	0.8	0.0	3.6	0.0	2.0	2.0	0.0	0.0
					(in percent of GDP)					
General government revenue 6/	44.1	43.3	43.3	43.0	41.7	41.6	41.2	41.3	41.3	41.7
Direct taxes	27.3	27.3	27.0	27.1	26.7	26.4	25.8	25.8	25.8	25.8
Indirect taxes	10.9	10.8	11.4	11.8	11.7	12.4	12.2	12.2	12.9	12.9
Other taxes and nontax	6.0	5.2	4.1	3.3	2.4	2.1	2.4	2.5	2.1	2.4
General government expenditure 6/	47.1	46.4	46.7	46.1	44.9	43.8	44.9	45.0	44.1	44.8
Goods and services	17.6	17.2	19.6	18.7	18.6	17.7	18.4	18.4	18.5	18.3
Transfers and subsidies	22.4	21.4	20.2	20.6	19.4	19.5	20.1	20.1	19.4	19.7
Interest payments	3.9	4.6	3.7	3.5	3.3	3.3	3.1	3.1	2.8	2.8
Capital and net lending	3.2	3.1	3.2	3.4	3.7	3.3	3.4	3.5	3.4	4.0
General government balance (cash)	-2.9	-2.7	-3.1	-3.1	-2.6	-2.3	-3.5	-3.5	-2.7	-3.1
General government bal. (comm.)	-3.0	-3.1	-3.4	-3.1	-3.2	-2.3	-3.8	-3.8	-2.7	-3.1
General government primary balance	0.9	1.5	0.4	0.4	0.0	1.0	-0.7	-0.7	0.1	-0.3
State balance (cash)	-3.3	-3.3	-3.3	-2.7	-2.4	-2.0	-2.1	-2.1	-2.3	-2.4
State balance (comm.)	-3.4	-3.7	-3.6	-2.7	-3.1	-2.0	-2.4	-2.4	-2.3	-2.4
Rest of government balance	0.4	0.6	0.2	-0.4	-0.2	-0.2	-1.4	-1.4	-0.5	-0.6
FUS	0.0	0.3	0.2	-0.3	-0.1	0.0	-1.3	-1.3	-0.4	-0.2
KRUS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Labor fund	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Local authorities	0.0	0.1	-0.1	-0.2	-0.2	-0.3	-0.1	-0.1	-0.2	-0.4
Health fund	...	...	...	...	...	0.0	-0.1	-0.1	-0.1	-0.2
Alimony fund	...	...	0.0	0.0	0.0	0.1	0.0	0.0	0.1	0.1
Fund for rehabilitation	...	...	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Environment fund	...	...	0.0	0.0	0.1	0.0	0.1	0.1	0.0	0.0
Other extrabudgetary funds	0.3	0.4	0.1	-0.1	0.0	0.1	0.0	0.0	0.0	0.0

Sources: Polish authorities and staff estimates

1/ The staff presentation and forecast are slightly different from the authorities'.

2/ Beginning in 1999, the health premium is allocated to the health funds and is not included in state budget totals. For comparability with previous years, this is estimated at Zl 18 billion in 1999 (3.1 percent of GDP).

3/ Fund presentation includes EU grants as revenue and associated spending as expenditure; government's presentation excludes EU grants entirely.

4/ Treats all local government financing as bank financing. For 1999 includes Zl 2.8 billion bank loan to FUS.

5/ In 1999, includes loan from state budget to FUS; in 2000, government's accounting treats ZL 3.4 billion in compensation payments and Zl 1 billion in loan to health funds as financing; Fund presentation puts these above the line in the state budget and treats the latter as a transfer to the health funds

6/ Total general government revenue and expenditures shown exclude some very small funds.

Table 6. Poland: Indicators of External Vulnerability
(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999 Latest Observation	Date of 99 Observation
Financial indicators					
Public sector debt	46.5	43.8	40.1	39.9	*December*
Broad money (percent change, 12-month basis)	29.5	29.1	25.2	19.3	*December*
Private sector credit (percent change, 12 month basis)	42.5	33.6	27.9	27.2	*December*
Domestic credit to GDP	33.5	34.8	36.4	39.1	*December*
13 week T-Bill rate 1/	18.8	23.5	13.6	16.2	*December*
13 week T-Bill real rate 2/	0.2	9.1	4.6	5.8	*December*
External Indicators					
Exports (percent change, 12-month basis in US$)	6.8	11.2	9.2	-12.2	*Jan-Dec*
Imports (percent change, 12-month basis in US$)	30.1	15.8	14.4	-4.7	*Jan-Dec*
Current account balance	-1.0	-3.0	-4.4	-7.6	*Jan-Dec*
Capital and financial account balance	3.2	3.8	7.6	6.4	*Jan-Dec*
o/w: Inward portfolio investment (debt securities etc.)	0.2	1.5	0.8	0.7	*Jan-Dec*
Other investment (loans, trade credits etc.)	1.0	0.1	2.8	0.9	*Jan-Dec*
Inward foreign direct investment	1.9	2.1	3.2	4.3	*Jan-Dec*
Net Foreign Assets (NFA) of commercial banks (in billions of US$)	6.5	7.8	4.1	7.9	*December*
Gross official reserves (in billions US$)	18.0	20.7	27.4	25.5	*December*
Net International Reserves (NIR) (in billions of US$)	18.0	20.6	27.4	25.5	*December*
Official reserves in months of imports GS	6.6	6.4	7.5	7.5	*December*
Reserve money to reserves (Ratio)	70.3	62.4	58.0	49.9	*December*
Broad money to reserves (Ratio)	2.6	2.4	2.3	2.5	*December*
Total short term external debt to reserves (in percent) 3/	26.5	24.6	20.6	23.3	*June*
Total external debt (in billions of US$)	47.4	48.9	56.9	59.9	*September*
o/w: Public sector debt	36.3	34.4	34.1	32.3	*September*
Ratio of short-term external debt to total external debt (in percent)	10.1	10.4	9.9	9.9	*June*
Total external debt to exports GS (in percent)	170	158	168	202	*December*
Total external debt service payments to exports GS	8.9	6.6	10.4	16.8	*December*
External interest payments to exports GS (in percent)	5.4	4.3	6.0	9.8	*December*
External amortization payments to exports GS (in percent)	3.5	2.3	4.5	7.0	*December*
Exchange rate (per US$, period average)	2.7	3.3	3.5	4.0	*December*
REER depreciation (-) (period average) 4/	8.4	1.8	5.6	-3.5	*December*
Financial Market Indicators					
Stock market index	14343	14668	12796	19470	*12-Jan-00*
Foreign currency debt rating 5/	BBB-	BBB-	BBB-	BBB	
Spread of benchmark bonds (basis points, end of period) 6/	35.0	77.0	102.0	47.1	*30-Dec-99*

Sources: Polish authorities and staff estimates.

1/ End-of-period.

2/ Backward-looking with actual CPI.

3/ By original maturity.

4/ CPI based.

5/ In Standard & Poor's rating system BBB- is investment grade whereas BB is below.

6/ Spread on Polish bond 7 3/4 coupon expiring 07/00 and US Treasury 5 7/8 coupon expiring 06/00.

POLAND: FUND RELATIONS
(As of December 31, 1999)

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

II. **General Resources Account**:

	SDR Million	Percent Quota
Quota	1,369.00	100.0
Fund holdings of currency	1,196.74	87.4
Reserve position in Fund	172.26	12.6
Operational budget transfers (net)	19.00	

On October 27, 1998, Poland consented to the increase in its quota to SDR 1,369 billion in accordance with paragraph 1 of the Board of Governors' Resolution No. 53-2 on "Increase in Quotas of Fund Members' Eleventh General Review."

III. **SDR Department**

	SDR Million	Percent Allocation
Holdings	8.13	N/A

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**:

	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	8/05/94	3/04/96	333.30	283.30
Stand-By	3/08/93	4/08/94	476.00	357.00
EFF	4/18/91	3/08/93	1,224.00	76.50

VI. **Projected Obligations to Fund**: None

VII. **Exchange Rate Arrangement**

The zloty had been pegged to a currency composite made up of the U.S. dollar, deutsche mark, pound sterling, French franc, and the Swiss franc. As of January 1, 1999, the currency composite was changed to a basket comprised of 55 percent euro and 45 percent U.S. dollar.

From January 1, 1995, the zloty was redenominated, with new Zl 1 equaling old Zl 10,000. The central parity of the zloty is adjusted under a crawling peg policy at a preannounced monthly rate. On May 16, 1995, a band of ±7 percent was introduced around the central rate. Following the implementation of the new system, the zloty initially appreciated by about 5 percent above the central rate. In September 1995, the exchange rate was allowed to appreciate a further 1 percent within the band. In December 1995, the central parity was raised by 6 percent, and at the same time the authorities allowed the actual exchange rate to appreciate by 2½ percentage points. On January 8, 1996 the monthly rate of crawl was reduced to one percent. On February 26, 1998, with the zloty pushing towards its upper limit, the newly-formed Monetary Policy Council (RPP) widened the fluctuation band from ±7 percent to ±10 percent. At the same time, the rate of crawl was reduced from one percent to 0.8 percent per month. On July 17, 1998, the crawling peg's monthly rate of depreciation was cut from 0.8 percent to 0.65 percent. On September 9, 1998, the monthly rate of depreciation was reduced further to 0.50 percent. On October 29, 1998, the zloty's trading band was widened to ±12.5 percent. On March 1, 1999, the zloty's trading band was widened to ±15 percent, and the rate of crawl was lowered to 0.3 percent per month. On December 31, 1999, the official rate was Zl 4.08 per US$1.

VIII. **Article IV Consultation**

The last Article IV consultation was concluded on March 11, 1999 (EBM/99/25). In concluding the 1998 Article IV consultation, Directors commended Poland's strong economic performance, notably sustained output growth and declining inflation. They approved of the intended rebalancing of economic policies—with continued fiscal consolidation accompanied by monetary relaxation—in response to the crisis in Russia in late 1998 and the slowing of growth in the EU. Directors welcomed the introduction of an inflation-targeting framework for monetary policy and considered the inflation target of not more than 4 percent by 2003 reasonable and achievable. They supported the parallel shift toward greater flexibility in the exchange rate. On structural policies, Directors commended the authorities' initiatives for pensions, health care, and administrative reforms that took effect in early 1999, and called for similarly bold initiatives in industrial restructuring.

IX. **Technical Assistance, 1992–99**

Department	Subject/Identified Need	Action	Timing	Counterpart
MAE-coordinated	Periodic visits by experts from central banks cooperating in providing technical assistance to the NBP under the coordination of MAE	Experts' visits	1992–94	NBP
MAE	Payments system, banking supervision, monetary	Mission	May 1992	NBP

	research and analysis			
MAE	Review of progress in the modernization of operational functions	Mission	Oct. 1992	NBP
MAE	Resident expert—Advisor to President of NBP		Nov. 1991–92	NBP
MAE	Additional steps in the modernization process of the NBP	Mission	April 1993	NBP
MAE	Monetary programming and operations, and payments system.	Mission	Nov. 1993	NBP
MAE	Central bank modernization	Mission	August 1994	NBP
MAE/LEG	Review of the exchange and payments system	Mission	February 1995	NBP/ MoF
MAE	Exchange rate system	Mission	March 1995	NBP
MAE	Review of government securities market, payments system and public debt management	Mission	August 1995	NBP/ MoF
MAE	Asset consolidation exercise	Expert visits	Late 1995	NBP
FAD	Tax administration (VAT)	Nine short-term assignments of field experts	August 1992–October 1994	MoF
FAD	Tax administration	Mission	November 1992	MoF
STA	Framework for monetary statistics	Mission	February 1993	NBP
STA	Framework for monetary	Mission	November 1993	NBP

	statistics (follow-up)			
STA	Government finance statistics	Mission	August 1995	NBP/ MoF
STA	Money and banking statistics	Mission	January 1996	NBP
STA	Government finance statistics	Mission	July 1996	NBP/ MoF
STA	Balance of payments statistics	Mission	November 1996	NBP/ MoF
STA	Balance of payments statistics	Follow-up Mission	April 1997	NBP/ MoF
STA	Review of progress in implementing the SDDS	Visit	February 1998	
FAD	Public expenditure management	Mission	April 1998	MoF
MAE	Operational aspects of monetary and exchange rate policy	Mission	September 1998	NBP
FAD	Tax administration	Mission	October 1998	MoF
FAD	Examination of impact on revenues of proposed tax reform	Mission	November 1998	MoF
FAD	Discussion of tax administration	Mission	March 1999	MoF
FAD	Tax administration seminar	Mission	April 1999	MoF
STA	Government Finance Statistics	Mission	October 1999	MoF/Local
FAD	Tax administration—introduction of expert	Mission	November 1999	MoF

X. Resident Representative

Mr. Rozwadowski, the Resident Representative, took up his duties in Warsaw in December 1997.

World Bank Activity Poland[1]

1. World Bank lending

As of December 31, 1999, loans totaling US$4.9 billion equivalent had been approved, the most recent being the Hard Coal Sector Adjustment Loan which was approved in November, 1999. This followed the approval of the Wholesale Market Projects I and II during the second half of 1998. As of January, 2000, twenty nine out of the 47 loans approved have closed.

The Bank's current assistance strategy for Poland was reviewed in the Country Assistance Strategy Progress Report approved by the Board in September, 1999. The CAS Progress Report provides an update on political and economic development and reviews the implementation and strategies of the 1997 CAS. The CAS's assessment is that Poland continues to make good progress in pursuing its political and economic transition agenda. Overall economic performance remains strong, with the preparation and implementation of additional structural reforms, as well as the legal and policy changes needed for EU membership, continuing to move forward. The country's democratic political framework is functioning well and was strengthened by the introduction of new elected councils at the regional level. Regarding the implementation of the 1997 CAS, the Bank's program remains consistent with the CAS objectives, but the program content has evolved substantially in light of the reforms being pursued by the current Government. The program is now much more sharply focused on the structural reform agenda, especially as it relates to some of the key reforms needed for EU accession. In next three years, the Bank's lending will support the hard coal sector reform, which relates directly to EU accession, and contribute toward progress in social programs critical for the sustainability of reform and the continuation of Poland's rapid growth.

2. Economic and sector work

Recent reports include:

> Transforming the State: Issues in Public Administration Reform, Report No.11797-POL, June 1993.
>
> Income Support and the Social Safety Net During the Transition, Report No. 11592-POL, January 1993.
>
> Private Sector Assessment, Report No. 11285-POL, January 1993.

[1] Prepared by World Bank staff.

Municipal Water and Wastewater Sector Study, Report No. 12660-POL, December 1993.

Poland-Policies for Growth with Equity, December 1994 (red cover).

Understanding Poverty in Poland, July 1995 (red cover).

Urban Transport Review, Report No.12962-POL, September 1995.

Country Economic Memorandum; Reform and Growth on the Road to the EU, Report No. 16858-POL, July 15, 1997.

Competitiveness Employment, A Framework for World Development in Poland, Report No. 17708, August 1998

Poland: Financial Report, December 1998

Poland: Complying with EU Environmental Legislation, April 1999

Poland: Strategic Priority for the Transport Sector, No. 19450, June 1999

Poland: Tax Reform In The Light of EU Accession, July 1999

Poland: Decentralization in Poland: Building Capacity For Sound Governance and EU Integration, June 1999

Poland: Education Opportunity Pilot Project, World Bank Technical Paper No. 454, August 1999

POLAND—STATISTICAL INFORMATION

1. Poland has a comprehensive and improving economic database. The authorities publish a full range of economic and financial statistics, and cooperate fully in providing information to the Fund. Data on the core indicators are available on a timely basis (see the attached data matrix). Consistent with its commitment to providing a comprehensive set of high quality data, in an open and timely manner, Poland subscribes to the IMF's Special Data Dissemination Standard (SDDS), and its metadata are posted on the Data Standards Bulletin Board.

Real sector statistics

2. The Central Statistical Office (GUS) issues a wide range of real sector statistics, most of which are published promptly in the monthly Statistical Bulletin. The main problems for users include (i) the short span of comparable Polish data series, reflecting the upheavals associated with transition to a market economy (ii) inconsistencies between annual and higher frequency data, reflecting differences in weights and differences in coverage, and (iii) lack of easy electronic retrieval of such data.

3. National accounts data still have some problems, particularly in the measurement of unrecorded cross-border trade, and in the treatment of changes in inventories. However, progress has been made. Most notably, the Central Statistical Office has started to issue quarterly national accounts statistics that now include estimates by expenditure category.

Government finance statistics

4. The authorities provide detailed state budget data to the Fund every month. In addition, government finance statistics are now reported to the Fund on a regular basis, and annual consolidated central government data are available in the Government Finance Statistics Yearbook. Monthly data on consolidated core operations of the central government are reported in *IFS*. However, the classification of transactions in the official data still needs improvement. In the meantime, the staff makes adjustments to the official data.

Monetary statistics

5. The National Bank of Poland (NBP) reports good quality data on a regular and timely basis to the area department. High-frequency data (every ten days) on the central bank balance sheet and the monetary survey are available with minimal delay. The data received by STA for publication in IFS are timely.

External sector statistics

6. While improvements have been made in the balance of payments data, some areas still need to be addressed. First, payments from the kantor market remain reported as a separate

item on the current account and not allocated across their current account components. Second, transfers remain reported as the sum of remittances from abroad and changes in residents' holdings of foreign exchange in the so-called "A"-accounts, which, strictly speaking, belong to the balance of payments. Third, differences in definitions remain between the customs (GUS) and payment (NBP) based trade data.

7. In the monetary survey the NBP now reports net foreign assets (NFA) rather than the net international reserves (NIR) previously supplied. In contrast to NIR, NFA includes less liquid foreign assets and liabilities. Finally, the coverage and reporting of the stock of external debt, especially at maturities up to one year, could be improved.

Poland: Core Statistical Indicators

As of January 31, 2000

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Central Government Balance	GDP/GNP	Public External Debt/ Debt Service
Date of Latest Observation	31-Jan	31-Dec	31-Dec	31-Dec	31-Dec	31-Jan	December	November	November	Nov-99	Q3	October
Date Received	31-Jan	17-Jan	17-Jan	17-Jan	17-Jan	31-Jan	17-Jan	17-Jan	17-Jan	January 14 2000	January	December
Frequency of Data	daily	every 10 days	every 10 days	every 10 days	every 10 days	daily	monthly	monthly	monthly	monthly	quarterly	monthly
Frequency of Reporting	daily	every 10 days	every 10 days	every 10 days	every 10 days	daily	monthly	monthly	monthly	monthly	quarterly	monthly
Source of Update	Reuters	NBP	NBP	NBP	NBP	Reuters	Reuters	NBP	NBP	Reuters	GUS	MoF
Mode of Reporting	on-line	fax	fax	fax	fax	on-line	on-line	fax	fax	on-line	fax	published report
Confidentiality	no	no	no	no	no	no	no	no	no	no	no	no
Frequency of Publication	daily	monthly	monthly	monthly	monthly	monthly	monthly	monthly	monthly	monthly	quarterly	monthly

Statement by the IMF Staff Representatives
March 14, 2000

1. This statement highlights economic and policy developments in Poland since the circulation of the staff report for the Article IV consultation (SM/00/36, February 18, 2000). This additional information does not change the broad thrust of the staff appraisal.

- In January, the current account deficit amounted to US$1.2 billion, about US$400 million less than December 1999, that still above its level in second half of 1999. Merchandise exports and imports declined in January, reversing the steady increases in both in late 1999. Foreign direct investment financed almost 2/3 of the current account deficit in January. International reserves stood at US$25.6 billion as of end-February, slightly higher than at end-December 1999.

- Industrial sales in January were 7.9 percent higher than a year earlier, well below the double digit increases recorded in late 1999. The decline in recorded growth rates coincides with methodological changes in the sample, however, which may distort the comparison. The registered unemployment rate continued its upward trend, reaching 13.6 percent in January from 13 percent in December 1999.

- Inflation rates edged higher as the January consumer price index increased 1.8 percent month-on-month, to reach 10.1 percent year-on-year. Seasonally adjusted food price inflation started to stabilize and nonfood price inflation decelerated.

2. The Monetary Policy Council (RPP) raised the official interest rates by 100 basis points on February 23, 2000, bringing the central intervention rate to 17.5 percent, the discount rate to 20 percent, and the Lombard rate to 21.5 percent. In its decision, RPP cited concerns over high inflation expectations and reaffirmed its commitment to achieving its end-2000 inflation targets. It also adopted a restrictive bias for the near future.

3. The zloty exchange rate remained strong, despite the weak current account data. Supported by large foreign exchange inflows, the zloty moved from 2 percent above parity at the beginning of the year to 5–6 percent above the parity recently.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 00/25
FOR IMMEDIATE RELEASE
March 31, 2000

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Poland

On March 15, 2000, the Executive Board concluded the Article IV consultation with Poland[1].

Background

Poland's economic performance during the past decade of transition has been outstanding. From 1993-1998, real GDP increased by an average of 5½ percent a year, while inflation declined from more than 35 percent to 8 percent. Unemployment was reduced to the low double digit level, with over two thirds of all jobs in the private sector.

In 1998-1999, the macroeconomic performance faltered, mainly due to the effects of strong external shocks. Exports were hard hit by the Russian crisis and the slowdown in EU demand. Combined with the loss of competitiveness to Asian countries, and the lagged effects of a countercyclical monetary tightening in 1997, real GDP growth decelerated to about 2 percent in the first half of 1999. Registered unemployment reversed a four year drop and rose to 13 percent. The current account deficit widened to 7.6 percent of GDP, reflecting the export demand shock and the structural trend of rising investment in the context of stable savings. Inflation, after reaching a low of 5½ percent in mid-1999, accelerated in the second half of the year, as the 12 month price increases rose to 9.8 percent in December, exceeding the official target of 6.6–7.8 percent. Though real wage increases have remained moderate, rising food and oil prices and the weakening of the zloty contributed to the inflationary pressure.

A planned reduction in the general government deficit failed to materialize in 1999. The slippage, amounting to 1½ percentage points of GDP relative to the general government deficit target, mainly reflected teething problems with the 1999 pension reforms: many contributors to the pension system exploited a loophole in the legislation which gave rise to a one month loss of revenue in 1999; collection ratios fell due to administrative problems and financial difficulties in some state owned enterprises; and planned improvements to the sickness benefit system were delayed. The central government cash budget, however, was on track as a cyclical slippage in revenues was offset by midyear increases in excise taxes and cuts in expenditures.

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[1]Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

After some easing of the monetary policy in early 1999 to bolster exports and activity, the Monetary Policy Council responded decisively to the acceleration in inflation by raising the central intervention rate by 100 basis points in September and by a further 250 basis points in November. In this context, the zloty strengthened by some 5 percent during December-January.

Despite the difficult macroeconomic environment, substantial progress has been made on the structural front. A wholesale reform of the government operations was initiated, mostly with effect from early 1999. A multi-pillar pension scheme was introduced; authority for public spending in certain areas was devolved to the local governments; a multi-stage process for establishing an internal market in the public health system was initiated, beginning with the creation of public health insurance funds; and the education system up to the middle school level was reformed. Parliament passed a major tax reform in late 1999. It substantially reduces corporate tax rates, reduces tax incentives and exemptions, and broadens the VAT base. Privatization was accelerated; with the sale of two large state banks and divestments in large state owned enterprises, receipts almost doubled from 1998 to reach 2.2 percent of GDP in 1999. Coal sector restructuring, supported by the World Bank, progressed: mines were closed, production cut and 25 percent of the coal workforce accepted redundancy packages or early retirement.

A strong recovery of growth started in mid-1999 and is expected to continue through 2000. Alongside the stabilization of the Russian market and the pick up in EU demand, investment and household demand accelerated. This was reflected in a sharp acceleration in credit to households, industrial sales, and GDP. Output growth is expected to rise over 5 percent in 2000, with a modest strengthening of the external current account balance. Inflation is expected to fall during 2000 owing to tight monetary and fiscal policies, the recovery of zloty from its late 1999 lows, continued high productivity growth, and moderating international energy prices. Wage pressure will be contained by the high unemployment rates, and the planned moderate budgetary wage increases.

Executive Board Assessment

Executive Directors commended the authorities for their strong record during the past decade, which has consistently placed Poland high among the most successful transition economies. As a result of firm macroeconomic and structural policies, economic growth has been robust, and inflation has been substantially lowered in recent years.

Directors noted that external developments—the Russian crisis, the deceleration of activity in Europe, and the increase in oil prices—had adversely affected economic developments in Poland in 1999. Economic growth had slowed, unemployment had edged up, the external current account deficit had risen sharply, and the general government deficit and inflation had exceeded the official targets. They welcomed the authorities' policy response to these challenges, which included a mid-year fiscal tightening and increases in interest rates.

While Directors noted the strength of direct foreign investment, the high rates of private fixed capital formation and the well-supervised financial markets, they considered that Poland was still vulnerable to changes in market sentiment if the external current account deficit did not decline.

Accordingly, Directors emphasized the importance of addressing the current account imbalance, as well as reducing inflation, by persevering in the implementation of fiscal adjustment in 2000. They stressed that progress on this front and continued implementation of the ambitious structural reform agenda should improve conditions for sustainable growth, as well as support the authorities' objective of securing early accession to the European Union.

Given the planned fiscal consolidation, the tight monetary stance, and continued wage moderation, the authorities' inflation target for the present year and for 2003 appeared achievable. Directors encouraged the authorities to strengthen the inflation targeting framework by announcing a target path toward the 2003 inflation target. These changes would buttress the anchor for inflation expectations and ensure the continuity and consistency in monetary policy making. Some Directors noted that the recent increases in official interest rates had been accompanied by a sizable appreciation of the zloty vis-à-vis the basket, and expressed concern about the effects of this appreciation on the external sector. In this connection, these Directors stressed the importance of proceeding with fiscal consolidation in order to ease pressure on interest rates and reconcile the tension between the price and external current account objectives.

Directors supported the authorities' intention to continue to abstain from intervention in the foreign exchange market—a policy that has served Poland well. Some Directors observed that the crawling exchange rate band no longer served a purpose under the inflation targeting regime, and could be safely abolished. A few Directors suggested, however, that this step be undertaken only after the current account had stabilized at a manageable level. Several Directors encouraged the authorities to lift the remaining controls on short-term capital inflows, and supported the objective of allowing the freer movement of capital. Other Directors believed that these controls should be lifted only as the current account deficit begins to decline.

Directors commended the authorities' commitment to balancing the budget over the medium term, which should make room for an increase in private investment by helping relieve pressure on the current account deficit over the coming years, during which investment is likely to be strong. Directors emphasized the need for public expenditure restraint, taking into account the necessity of deficit reduction, the initial cost of structural fiscal reforms, and prospective expenditures related to EU accession. They welcomed the authorities' commitment to reform the tax system, the pension system, and the devolution of fiscal responsibilities to local governments. Over time, these reforms should further enhance efficiency and result in greater budgetary savings. Although local governments behaved in a restrained fashion, Directors urged the authorities to put in place an effective mechanism to monitor and help strengthen the framework for local government finances. They welcomed the authorities' intention to carry out a fiscal transparency assessment during 2000.

Directors noted the continued improvements in Poland's already strong banking supervision and regulatory framework. In light of the increasing amounts of fixed capital investment channeled through the banks and the associated large current account deficit, they welcomed the authorities' decision to proceed with a Financial Sector Assessment Program (FSAP) in 2000.

Directors welcomed the authorities' commitment to rapid completion of industrial restructuring and privatization. These reforms would be essential for the continued dynamism of the economy, and contribute to the preparation for EU accession. They viewed flexible labor market structures and reforms to encourage private investment as central to the more rapid creation of employment. In this regard, most Directors welcomed the authorities' plans to reform the minimum wage, and urged them to achieve any reductions in the work week without imposing rigidities on employers. They urged the authorities to continue to resist direct interventions, such as import protection and export subsidies.

While noting that Poland has subscribed to the Special Data Dissemination Standard and its statistical base is adequate for surveillance, Directors encouraged the authorities to continue to improve the quality of macroeconomic data, in particular balance of payments data and the transparency of fiscal data.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. As part of a pilot project, the staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 1999 Article IV consultation with Poland is also available.

Poland: Main Economic Indicators

	1995	1996	1997	1998	Estimate 1999
Real economy (change in percent)					
Real GDP	7.0	6.0	6.8	4.8	4.1
Real domestic demand	4.5	12.2	9.4	6.5	4.9
CPI (end-year)	21.6	18.5	13.2	8.6	9.8
Unemployment rate (in percent)	14.9	13.2	10.3	10.4	13.0
Gross national saving (percent of GDP)	24.0	21.0	21.7	22.0	19.9
Gross domestic investment (percent of GDP)	19.8	22.0	24.7	26.4	27.4
Public finance (in percent of GDP)					
General government balance 1/	-3.1	-3.4	-3.1	-3.2	-3.8
Public debt	52.5	46.5	43.8	40.1	39.9
Money and credit (end of period, percent change)					
Net domestic assets 2/	5.2	19.7	14.1	17.5	12.8
Money and quasi-money	34.8	31.2	29.1	25.2	19.4
Lending rate (annual average in percent)	33.5	26.1	25.0	24.5	17.3
Balance of payments in convertible currencies					
Trade balance (in percent of GDP)	-1.5	-5.7	-7.9	-8.7	-9.4
Current account (in percent of GDP)					
Including unrecorded trade	4.2	-1.0	-3.0	-4.4	-7.6
Gross official reserves (in billions of U.S. dollars)	15.0	18.0	20.7	27.4	25.5
Reserve cover (months of merchandise imports)	7.2	6.6	6.4	7.5	7.5
External debt (end of period) 3/					
(In billions of U.S. dollars)	44.0	47.4	48.9	56.9	60.9
External debt service ratio 4/					
Due	13.3	8.9	6.6	10.4	16.8
Paid	13.3	8.9	6.6	10.4	16.8
Fund position (in millions of SDRs)					
Quota					1369.0
Holdings of zloty (end-December 1999)					1196.7
Holdings of SDRs (end-December 1999)					8.1
Exchange rate					
Exchange rate regime	Crawling Band 5/				
Present rate	Zl 4.1011 per US$1 (March 14, 2000)				
Depreciation (-) against U.S. dollar					
(period average, in percent)	-6.3	-10.1	-17.8	-5.6	-12.4
Depreciation (-) of real effective exchange rate					
(relative CPIs, in percent)	6.6	8.4	1.8	5.6	-3.5

Sources: Central Statistical Office; data provided by the authorities; and IMF staff estimates.

1/ On a commitment basis.

2/ In relation to broad money at end of the previous year.

3/ The external debt data for 1998 and 1999 are not directly comparable to the previous years as the coverage was changed.

4/ In percent of exports of goods and services in convertible currencies, including the Fund.

5/ The zloty currently floats within a + 15.0 percent band around the central rate, which depreciates at a fixed monthly rate (0.3 percent since March 24, 1999) against a basket of currencies.

Statement by Wieslaw Szczuka, Alternate Executive Director
for Republic of Poland
March 15, 2000

At the onset, I would like to thank the staff for the interesting report, the accompanying background papers, and for the valuable set of policy recommendations. Poland has benefited from the Fund's advice and assistance from the very beginning of its transition to market economy and we are interested in continuing this fruitful policy dialogue.

My authorities broadly share the staff appraisal and note with appreciation the generally positive assessment of Poland's economic policies and progress in implementing structural reforms. If there are diverging views between the authorities and the staff, they are mostly confined to such issues as the appropriate timing of implementing certain measures or different assessment of some risks.

The staff correctly identified external imbalance and inflation as the most immediate targets for macroeconomic policy. However, it needs to be stressed that progress in dealing with these issues should mainly be seen as a means to achieving the overarching objectives of sustainable growth, employment creation and assuring Poland's accession to the European Union.

Recent economic developments and prospects

The 1999 GDP growth of Polish economy has been estimated at 4.1 percent and it is widely believed that the officially projected 5.2 growth rate in 2000 will be achieved, or even exceeded. For some economic analysts this is a proof that, I quote, "Poland is pulling out of the effects of the external shocks with amazing ease", and that we observe a V-shaped recovery after the temporary slowdown in late 1998 and early 1999. This is confirmed by the quarterly distribution of GDP growth rates ranging from 1.5 percent in the first quarter to over 6 percent in the forth quarter of last year.

However, this vigorous output recovery was mainly supported by the strength of the domestic consumption demand and was accompanied by an increase in the external current account deficit to 7.6 percent of GDP. Also, while the average inflation decreased by more than expected (from 11.8 percent in 1998 to 7.3 percent) the year-end inflation increased for the first time since the beginning of Poland's transition and reached 9.8 percent. The general government deficit exceeded the targeted level by about one percentage point (mostly on account of one-time "teething" problems associated with the implementation of the social security and health sector reforms) and the unemployment rate edged up to over 13 percent.

While most of these less favorable developments can be explained by the combination of three major external shocks (Russian crisis, weakness of EU demand and oil price increases) and not fully anticipated costs and problems at the start of four important structural reforms, they all call for an adequate policy response. My authorities have already decisively reacted to this situation by the significant tightening of monetary policy and by targeting a sizable, 1.5 percentage points of GDP fiscal adjustment in 2000. Attaching great importance to reducing the current account deficit, the government adopted on February 1, 2000 a set of measures that should help in promoting the development of Polish exports. My authorities are also determined to proceed full speed with the implementation of the very broad structural reforms agenda. These measures plus the visibly improved external environment should result not only in sustaining the growth prospects, but also in a gradual reduction of the external and internal imbalances.

Fortunately, even a relatively large current account deficit does not present any immediate threat to the Polish economy. Such factors as the good record of sound financial policies, large flexibility of the exchange rate, high official reserves, low level of short-term indebtedness, sound financial sector and strong prudential regulations and supervision make Poland very resilient to any possible change in market sentiment. Foreign investors' confidence is reflected in strong inflows of direct investments and portfolio capital that assure full financing of the current account deficit, but also exert a not so welcomed upward pressure on the zloty.

Fiscal policy and tax reform

The need to consolidate public finances in order to sustain disinflation and reduce the external imbalance is very well understood by my authorities. The 10-year Strategy of Public Finance and Economic Development adopted by the Polish government in June 1999 aims at achieving a balanced budget by the year 2003. This task is made more complex by the government's firm intention to reduce the level of fiscalism through a comprehensive tax reform and the additional expenditure pressures associated with EU and NATO accession, restructuring of agriculture and public enterprises, environment clean-up etc.

Last year's fiscal slippage was entirely unintended and reflected almost exclusively the difficulties in introducing four major structural reforms having a profound impact on the system of public finance. This mainly concerns the pension reform, where the start-up costs have been significantly augmented by the ill-functioning computer system and by some imperfections in the relevant legislation. Despite the cyclically depressed revenues, the targeted level of the state (central) budget was not exceeded thanks to some compression of expenditures and earlier unplanned increases in excise tax rates. The 2000 budget is based on quite conservative assumptions and with generally improving economic conditions should be implemented without major difficulties. The preliminary data for February show that after two months the state budget deficit is fully under control and is much lower than in 1999. With somewhat reduced tensions in the pension system the main risks of slippages outside of the central budget could be associated with the health reform and with the restructuring of some public enterprises.

As opposed to the staff, my authorities are rather less concerned that already in the current year there may be a significant risk of a large increase in borrowing by the local authorities. Even though the quite restrictive rules limiting such borrowing are not yet binding there is no compelling evidence of any rush to credits at the local levels. This is also not encouraged by the rising real interest rates, by a rather cautious attitude of the financial institutions and by the shortage of resources that the local authorities could spend on servicing the debt. Because of that, my authorities do not consider it necessary at this stage to introduce the additional restrictions on borrowing at subnational level that have been suggested by the staff. This would require changing the current legislation and could be perceived as running against the spirit of increasing the autonomy of local governments. At the same time, my authorities intend to monitor closely the debt of all public sector institutions, as required by the constitution and the law on public finances.

The main goal of the comprehensive tax reform initiated in 1999 is to simplify the tax system and make it more supportive of government's objectives of high growth and rapid job creation. This should be achieved by reducing the burden of direct taxation while eliminating various allowances and tax incentives and broadening the base for the VAT. Several excise tax rates need also to be raised to make them more conform to the EU levels. In accordance with the new corporate income tax law adopted in 1999 the rate paid by incorporated businesses has already been lowered from 34 to 30 percent and should be gradually reduced to 24 percent in 2004. At the same time, the VAT coverage has been extended to various public services, the scope for using preferential VAT rates has been curtailed, and excise tax rates on gasoline, cars, alcohol and tobacco products have been adjusted upward. The government has also adopted the draft legislation providing for the extension of the VAT to agriculture, in several steps, starting with the introduction of a preferential rate for low-processed food products in mid-2000. My authorities are determined to proceed with the reform of the personal income tax. The exact shape of this reform is still being discussed by the coalition partners and the possible options range from reintroducing the proposal, that was submitted last year, to focusing the changes on unifying the taxation of corporate and unincorporated businesses.

Monetary and exchange rate developments

The overshooting of the 1999 inflation target and the recent return to two-digit inflation rates (10.1 percent in January) is clearly disappointing. Fortunately however, all projections indicate that inflation should soon resume its downward trend and there are still good chances of reaching the current target of 5.4 to 6.8 percent. To some extent, the Monetary Policy Council (MPC) fell victim of its own decision (otherwise well justified by transparency considerations and necessitated by Poland's statistical realities) to target CPI instead of a core inflation measure. A large part of last year's acceleration in inflation can be attributed to unexpected oil and food price increases, with the latter being in part the result of government's intervention on the food market. However, the indicators of core inflation were also on the rise since summer last year, reflecting both the strong domestic demand, fueled by the consumer credit and the reform-related fiscal slippage, and the more depreciated

exchange rate. The earlier unplanned indirect tax increases were yet another factor contributing to inflationary pressures.

The MPC reacted decisively to these developments by raising all basic interest rates by 250 to 350 basis points on November 17, 1999, after a smaller, 100 basis point increase of the intervention rate in September. On February 23, 2000, all interest rates were raised again, this time by 100 basis points, and the MPC announced a tightening bias.

The recent MPC decisions provide a clear indication that it attaches utmost importance to reaching its medium-term inflation target of below 4 percent by the year 2003. The continuation of the central bank's (NBP) policy of non-intervening on the foreign exchange market and the decision to stop, as of June 1999, purchases of foreign exchange when fixing the official exchange rate, contributed to eliminating the main source of base money expansion. In September 1999, the NBP drastically reduced the reserve requirements on zloty deposits and unified them with the rates for foreign exchange deposits at the level of 5 percent. While this decision, which was motivated by the need to strengthen the competitive position of all Polish banks, could have had an immediate expansionary effect, the NBP prevented this from happening by obliging the banks to purchase its own long-term securities. In addition, the NBP reached an agreement with the Ministry of Finance to convert a large amount of various illiquid claims on the government (with a total value of about 16 billion zloty) into marketable securities. This provided the NBP with a powerful tool that it intends to use in implementing its strategy of reducing the structural overliquidity of the Polish commercial banks.

Seeing a potential conflict between monetary tightening and the stabilization of the external current account, staff advise caution when considering any further interest rate increases. This view may in part be corroborated by the recent acceleration of foreign capital inflows that drove the Polish zloty up to about 6 percent on the strong side of its parity. The foreign capital seems to be attracted by both an attractive short-term carry trade and by the convergence play at the long end of the yield curve. The MPC is not neglecting the external risks, but it sees its main duty in fulfilling the constitutionally mandated task of reducing inflation and preserving the value of the domestic currency. In its view the problem of the growing current account imbalance should be dealt with by the appropriate coordination of fiscal and monetary policy, and by other instruments under control of the government such as trade, incomes and labor market policies, privatization, enterprise restructuring and other structural reforms. In the MPC's view, strengthening of domestic savings is the main prerequisite for achieving any lasting improvement in the external current account, and this objective would not be well served by a premature easing of monetary policy.

With the intent of reducing, or at least smoothing, the pressures on the zloty exchange rate resulting from bulky privatization payments, the government and the NBP reached a preliminary agreement on establishing a special foreign exchange account that would absorb part of the privatization-related inflows. Staff's assertion that such inflows do not exert any marked impact on the forex market seems to be somewhat questionable. After all, with large current account deficit the value of the zloty is mainly driven by the current and expected capital inflows. Taking into account the elimination of the fixing purchases and the already

increased net foreign assets of the commercial banks, it does not seem very probable that the expected privatization inflows in the range of several billion dollars would not visibly influence the market value of the zloty. The establishment of the proposed foreign exchange account would also indirectly lead to implementing staff's suggestion that the level of central bank's official reserves should not be influenced by the debt service payments.

In order to allow the operation of the direct inflation-targeting framework in its pure form the NBP has envisaged the complete elimination of the present +/-15 percent crawling band. This issue is still under review, but neither my authorities, nor the staff see any urgency in deciding on freeing the zloty given the sufficient flexibility offered by the present width of the band. While the staff adopted a rather neutral stance on the more or less innocuous issue of removing the band, they make quite a strong plea in favor of removing the remaining controls on short term capital movements. Admittedly, in both cases staff agree with delaying such steps until the current account has stabilized. However, in the latter case, this position may appear slightly inconsistent - why wait with the introduction of a decision that staff considers clearly beneficial. As reported by the staff, my authorities are less convinced that the short-term gains from full capital account liberalization would outweigh the risks of a significantly increased exchange rate and capital flows volatility at time of a sizable current account imbalance. Would Poland really benefit, at this stage, from more short-term portfolio inflows or more short-term borrowing by Polish enterprises? Despite the recent decision to postpone the abolition of the residual controls on capital flows, Poland remains committed to introducing full liberalization of the capital account before the accession to the EU, and not later than by the end of 2002.

What happened to Poland's current account?

The difficulties with providing a clear answer and convincing answer to this question are well illustrated by the staff's frank admission that the reasons for the recent weaknesses are not yet well understood. Staff is trying to solve some part of this puzzle by pointing to differences between Polish and EU statistics and to the differing experience of other transition countries, that recorded stronger export growth. Although inconsistent international statistics, breaks in the series of Polish trade data, and large swings of the dollar/euro rate certainly mask some real developments, there must also be other more fundamental macroeconomic factors explaining the recent unsatisfactory behavior of Polish exports and current account. Many such factors have been presented by the staff, including, first and foremost, the strong investment growth that has not been matched by an equally fast growth of domestic savings. This, together with the fast growing direct investment inflows, points to the existence of a large structural part in Poland's current account deficit that may be well justified at this stage of the transition process.

Among obvious causes of the deterioration in Poland's trade account one can name the loss of the substantial share of the Russian and other CIS markets after the crisis of August 1998 and, on the import side, the sharp oil price increases. The loss of the eastern markets (with exports to Russia falling by over 60 percent, and to Ukraine by almost 40 percent, in the first three quarters of 1999) is not only the reflection of the exchange related

loss of competitiveness of Polish products on these compressed and struggling markets. The EU food exports to Russia increased in 1999, according to the preliminary estimates, by almost 50 percent and exceeded its pre-crisis level. This is a clear indication that Polish exports to the CIS countries are being pushed out by the heavily subsidized EU (and most probably also US) exports. Poland was harder hit by the Russian crisis than other Central European countries because it had a larger share of trade with the CIS countries (with Russia alone accounting for more than 8 percent) and because of the importance of the revenues from the so-called border trade. The $2.4 billion decline in revenues from unclassified current account transactions (mainly representing fall in the "unrecorded" trade) was the single most important item contributing to the increase in the current account deficit in 1999. There is also some evidence that the depreciation of the CIS currencies contributed to the relocation from Poland of some export processing orders and increased the competition for Polish products on some CEFTA markets.

Several factors may help in explaining the apparent weakness of Polish exports to the EU despite the economic recovery observed in most of the EU countries. This includes also the fact that due to the weakness of the euro, this recovery is mainly export driven, and less import inducing. First of all, however, it has to be stressed that Poland's export to EU is weak only in dollar terms and increased last year in both euro and volume terms. This happened despite a nominal appreciation of the zloty/euro exchange rate by more than 8 percent between March 1999 and March 2000. The better export performance of some other CEFTA countries may reflect divergent commodity structures and differences in the degree of export orientation of FDI's located in Poland and in other countries with smaller domestic markets.

Looking beyond the EU, my authorities agree with the staff that although there is no indications of any general deterioration of Poland's competitiveness, last year's export performance was clearly affected by the significant appreciation of the Polish currency in the course of 1998. Also, Poland's unwavering commitment to trade liberalization - reflected in the reduction of the effective tariff rate to 3.4 percent in 1999 and in the almost completed liberalization of trade with the EU and CEFTA countries - exposed the Polish trade sector to the very strong competition from countries with generally much better developed export promotion mechanisms.

Despite the somewhat disappointing current account data for January 2000, with the deficit reaching $1.2 billion and exports declining by 9 percent, the outlook for the whole year points to a moderate reduction of the current account to GDP ratio to below 7 percent. In seasonally adjusted terms Poland's trade deficit has stabilized already in mid-1999 and has even narrowed after excluding the effects of the surge in oil prices. The confidence of foreign investors has remained very strong as evidenced by the very high inflow of FDI's ($766 million in January) even before the start of this year's large privatization projects. It is probably not by chance that Poland was placed on the fifth position in the ranking of 60 preferred foreign direct investment destinations (the FDI Confidence Index) that was recently published by the management consulting firm A.T.Kearney. Another proof of strong market confidence is the very good reception of Poland's first euro-denominated sovereign bond issue. The size of this 10-year bond that was issued last week with the spread of 82

basis points had to be increased from 400 to 600 million euro in response to very strong investors' demand. It is also worth noting that Poland, as the first emerging market country, will soon be included in the popular government bond index (GBI) composed by the US investment bank JP Morgan.

Progress in structural reforms

The staff report, and in particular the Selected Issues paper, provide a very detailed and accurate description of Poland's progress in implementing the far-reaching structural reforms in fiscal and other areas. Staff's assessment of the direction and pace of these reforms is generally favorable and I am inclined not to disagree with this staff's opinion. The four "big" reforms initiated in 1999 (social security, health, education and public administration) should have a very profound, lasting and beneficial impact on the long-term sustainability of public finances and on the efficiency in delivering public services. The privatization program has been significantly accelerated and broadened to include most remaining sectors, including energy, transportation, and insurance. With an almost completed privatization of the banking sector the strong foreign investors' interest in the presence on the Polish market has been reflected in the new phenomenon of very intense takeover battles to gain control over the earlier privatized banks. The restructuring of coal and steel sector proceed with varying speed and not without difficulties, but a significant progress has also been achieved in these crucial areas. My authorities are fully aware of the utmost importance of reforming the labor market and removing all obstacles to the creation of new jobs. The government's efforts in this area will be guided by the recently adopted National Strategy of Employment Growth and Development of Human Resources in years 2000-2006. Several elements of the minimum wage reform proposed by the staff are included in the draft legislation that has been submitted to the parliament.

To conclude, I would like to stress that my authorities remain strongly committed to transparency on all areas of their activities. This has been reflected in joining the pilot project for publication of the Article IV staff report and in the immediate release of the concluding statement at the end of the mission's visit to Warsaw. My authorities have also requested the inclusion of Poland into the Financial Sector Assessment Program and cooperate with the Fund in conducting the assessment of Poland's conformity with the rules and principles of fiscal transparency.