Folder Title: Poland - Country Files - Correspondence - Volume 1

Folder ID: 1779845

Dates: 2/27/1985 – 6/14/1991

ISAD(G) Reference Code: WB IBRD/IDA EXC-11-49S

Series: Country files

Sub-Fonds: Records of President Barber B. Conable

Fonds: Records of the Office of the President

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POLAND

Record Removal Notice

File Title	Barcode No.
Poland - Country Files - Correspondence - Volume 1	1779845

Document Date	Document Type
April 11, 1991	Letter

Correspondents / Participants
From: President Barber Conable
To: Mr. Wladyslaw Golebiowski

Subject / Title
Appointment as WBG Alternate Governor for Poland

Exception(s)

Additional Comments

Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Ann May	September 28, 2015

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Poland - Country Files - Correspondence - Volume 1	1779845

Document Date	Document Type
June 14, 1991	Memorandum

Correspondents / Participants

From: Anil Sood, Acting Director EM4

To: Mr. J. S. Baijal, EDS12

Subject / Title

Poland - Land Ownership and Constraints to Privatization

Exception(s)

Additional Comments

Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Ann May	September 28, 2015

Poland

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

February 11, 1991

His Excellency
J. K. Bielecki
Prime Minister
Council of Ministers
Al Ujazdowskie 1/3
00-583 Warsaw
Poland

Dear Mr. Prime Minister:

Thank you very much for your letter of January 17, 1991 in which you state your Government's determination to pursue actively a program leading to Poland becoming a modern market economy, and emphasize the importance of privatization and participation of foreign capital. I wish to reaffirm our readiness to continue working with you and your Government to support Poland's reintegration in the world economy through effective implementation of the broad reform program in which it is engaged.

I noted from your speech at Davos, and from your letter, the importance that you attach to dealing with the problem of Poland's debt overhang. We share the view that Poland's reform and development programs could be jeopardized if an appropriate solution is not found to Poland's heavy indebtedness. As you know, we have made these views known to the international community. We are greatly encouraged by recent indications which suggest that adequate solutions are within reach.

I wish to reiterate our position that, provided a viable reform program is vigorously implemented and an adequate overall debt workout is supported by Poland's current creditors, the World Bank would be willing to consider providing financial support for a program of debt and debt service reduction in the case of Poland's commercial obligations.

Due to their interest in these matters, I am sending copies of this letter to Deputy Prime Minister Balcerowicz and Mr. G. Wojtowicz, President of the National Bank of Poland.

With best regards.

Sincerely,

(Signed) Barber B. Conable

Cleared and cc: Messrs. Lari and Nouvel (EM4)

cc: Messrs. Ryrie (CEXVP); Qureshi (OPNSV); Stern (FINSV), Thalwitz (PRESV)

cc: Messrs. Wapenhans (o/r), Chopra (Acting EMNVP)
Thumm, Lav (o/r), de la Calle (o/r) (EM4)
Hume (EM4RM)

bcc: Messrs. Caranza and Ilczuk (EDS)

JLoos\
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W/MAQ for clearance per Jomeini 2/12

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO: Mr. M. Qureshi (E-1241)	DATE: 1/28/91

SUBJECT:

Document From: Amb. Dziewanowski
To: bbc
Dated: 1/28/91

Reference No.: EXC910128003

Topic: Poland: encl. a ltr. from the new Prime Minister, Mr. Jan Krzysztof Bielecki, & for a fruitful relationship w/WBank.

ACTION INSTRUCTIONS: | DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
__XXX__ PREPARE RESPONSE FOR _BBC'S SIGNATURE — 2/12/91
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: cc for info: Messrs. Stern, Thalwitz, Ryrie

AMBASSADOR OF THE REPUBLIC OF POLAND

January 28, 1991

Honorable
Barber Conable

President,
The World Bank
Washington, D.C.

Dear Sir,

I have the honor to enclose the letter from His Excellency Jan Krzysztof Bielecki, Prime Minister of the Republic of Poland.

Please accept, Sir, renewed assurances of my highest consideration.

Kazimierz Dziewanowski

The World Bank

Warsaw, January the 17th, 1991

Dear Mr. President,

As you may know, on January 4, 1991, the Parliament of the Republic of Poland entrusted me with the responsible post of Prime Minister.

The Government of the Republic of Poland, over which I have the honor to preside, is determined to be firm and persistent in the pursuit of changes necessary to build a modern market economy. The key elements in this process are privatization and the influx of foreign capital. Both of these factors are seriously threatened by the magnitude of Poland's foreign debt. In view of the gravity of the issue, President of the Republic of Poland, Mr. Lech Wałęsa, has requested the leaders of the seven world's most developed nations for their personal commitment to finding an earliest possible solution to the problem.

World Bank participation in the creation of infrastructure necessary for Poland's economic growth will to a significant degree depend also on finding a permanent solution to the Polish debt problem. From what I know of your views on this issue, I am convinced that I can count also in the future on full cooperation and assistance of the World Bank.

Sincerely yours,

His Excellency
Mr. Barber CONABLE
President
The World Bank

For: BBC & ~~SS~~ (FYI)
(to read before going to see Mr. Lari)
Poland

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

January 25, 1991

His Excellency
Lech Walesa
President of the Republic of Poland
Belvedere
Warsaw, Poland

Dear Mr. President:

Please accept our warm congratulations on your recent election. We look forward to working with you and the Polish authorities to support Poland's move to a market economy and its reintegration in the world economy, through effective implementation of the broad reform programs in which it is engaged.

We believe that Poland has made remarkable progress in the past year on its reform and adjustment programs. Despite the costs incurred so far, Polish society has established a good platform on which to build. We are very pleased that you not only have reaffirmed, as part of your priority agenda of work for the 1990s, the basic reform objectives developed during the past year, but have also indicated your intention to accelerate the reform process.

We recognize that the reform process is complex and difficult, with important political dimensions which condition the shape and pace of reforms; you will therefore find the World Bank imaginative and flexible in supporting Poland in reform and development programs, within the context of the reaffirmed sound macroeconomic management. Since initiating lending to Poland in early 1990, the World Bank has provided six loans amounting to about $1.1 billion, and we are working with your authorities to prepare further programs and projects which call for substantial additional World Bank lending over the medium term.

In addition to providing substantial assistance to Poland's reform and development efforts, the World Bank is also working with other interested bilateral and international sources, such as the European Community and European Investment Bank, which has already cofinanced two of our operations. We also expect the new European Bank for Reconstruction and Development to be an effective partner in cofinancing some of the projects under consideration.

We share the view that Poland's reform and development programs could be jeopardized if Poland's current debt overhang is not relieved. As you know, we have made these views known to the international community. We are greatly encouraged by recent responses by the international community which suggest that adequate solutions are now within reach.

Due to their interest in these matters, I am copying this letter to His Excellency Prime Minister J. K. Bielecki, Deputy Prime Minister Balcerowicz, and the President of the National Bank of Poland, Mr. G. Wojtowicz.

Sincerely,

Barber Conable

Barber B. Conable

to be cleared and cc: Messrs. Qureshi and Wapenhans

cc: Messrs. Lari, Thumm, Hume, Nouvel, Lav, de la Calle

bcc: Messrs. Caranza and Ilczuk (EDS)

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Poland

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

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President

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Belvedere
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Sincerely,

Barber Conable

Barber B. Conable

to be cleared and cc: Messrs. Qureshi and Wapenhans

cc: Messrs. Lari, Thumm, Hume, Nouvel, Lav, de la Calle

bcc: Messrs. Caranza and Ilczuk (EDS)

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Poland AK SS

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	10/29/90

SUBJECT:

Document From: Mr. Ryrie
To: bbc
Dated: 10/26/90 Reference No.: EXC901029001

Topic: Fund for Poland (re 10/25 Financial Times remarks of MAQ)

ACTION INSTRUCTIONS:	DUE DATE:

_______ HANDLE
_______ REVIEW AND RECOMMEND
_______ FOR YOUR INFORMATION
__XXX__ DISCUSS WITH __BBC FOR COMMENTS __
_______ AS WE DISCUSSED
_______ PREPARE RESPONSE FOR ______ SIGNATURE
_______ FOR YOUR FILES
_______ RETURN TO ______________________
_______ OTHER: ________________________

Remarks: note -- Mr. Ryrie's secretary has already distributed copies to PC Members (as discussed with Brenda 10/29)

International Finance Corporation
Washington, D.C. 20433
U.S.A.

Sir WILLIAM RYRIE
Executive Vice President

October 26, 1990

Mr. Barber B. Conable

Barber.

Fund for Poland

I was concerned to see the report in yesterday's Financial Times about remarks made by Moeen Qureshi in Warsaw about a possible fund to speed up private investment in Poland. The report is not very precise and I realize that it may be very inaccurate. But I hope we are agreed that the idea of creating a large Fund with Bank and EIB money, which would have to be covered by government guarantees, would be the wrong way to go about attracting private investment to Poland. The only type of "seed capital" which should be considered in this context should be non-recourse, risk-taking funds which can help to promote private investment on a genuinely market basis.

There are important issues here and there is a danger of undermining the basic objective of creating market economies if we go about things in the wrong way. I hope we shall have a chance to discuss any proposals of this kind before plans are made.

Bill

cc: Members of the President's Council
G - 4

WSRyrie:mts

X

Multilateral Investment Guarantee Agency
Washington, D.C. 20433, U.S.A.

BARBER B. CONABLE
President

October 17, 1990

Dear Mr. Deputy Prime Minister:

Thank you for your letter dated September 14, 1990, informing us of the appointments of Mr. Janusz Sawicki, Undersecretary of State in the Ministry of Finance, and Mr. Zbigniew Piotrowski, President of Foreign Investment Agency, as Governor and Alternate Governor, respectively, for Poland on the Council of Governors of the Multilateral Investment Guarantee Agency. Our records have been amended accordingly.

We look forward to working closely with Mr. Sawicki and Mr. Piotrowski in the coming years.

Sincerely,

(Signed) Barber B. Conable

The Honourable
Leszek Balcerowicz
Deputy Prime Minister and
Minister of Finance
Ministry of Finance
ul. Swietokrzyska 12
P. O. Box 20
00-910 Warsaw, Poland

cc: Mr. Caranza

ETSanidad:jlk

RZECZPOSPOLITA POLSKA
WICEPREZES RADY MINISTRÓW
MINISTER FINANSÓW

Warszawa September 14, 1990

Dear Mister President,

I wish to inform you that the Council of Ministers with the decision of September 10 ,1990 No. RM-031-33-90 authorized Ministry of Finance to conduct cooperation with the Multilateral Investment Guarantee Agency.
Following this decision I designated Undersecretary of State in Ministry of Finance Janusz Sawicki as Governor of the MIGA for Poland and President of Foreign Investment Agency Zbigniew Piotrowski as Alternate Governor of the MIGA for Poland.

Sincerely yours

Leszek Balcerowicz

Mr. Barber B. Conable
President
The International Bank for Reconstruction and Development
Washington D.C.

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BBC
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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: October 4, 1990

TO: Files

FROM: Ian Hume, Director, RMPOL

SUBJECT: POLAND - 1990 Annual Meetings, Meeting with Mr. Conable (September 27, 1990)

Attendance

Delegation:

Prof. W. Baka, President NBP and Bank Governor

Mr. L. Balcerowicz, Deputy Prime Minister and Minister of Finance

Mr. W. Trzeciakowski, Minister of Aid Coordination

Mr. G. Wojtowicz, Vice President NBP and Bank Alt. Governor

Mr. A. Ilczuk, Adviser, EDS21

Bank:

Messrs. Conable
Qureshi (OPNSV)
Thalwitz (PRESV)
Wapenhans (EMNVP)
Lari (EM4DR)
Hume (RMPOL)
Vergin (AS4DR)

1. Mr. Conable opened the meeting by stressing that the Bank was pleased to be able to be of assistance to Poland, in its role as a global institution, and that it would do this without starving resources in other regions of the world. The Bank was anxious to see Poland broaden and deepen its reforms, and Mr. Conable said we hoped this process would not be interrupted by the coming elections.

2. Mr. Balcerowicz thanked the Bank for its support, and gave his opinion that, although there were some political differences between different groups in Poland, there was no great divide on the broad substance of the economic reform program. In his view there was a "reasonable chance" of the reform program being continued after the election. More important than the election were the three external shocks facing Poland--the collapse of the CMEA funding relationships; the Gulf Crisis; and the negative economic impact of German unification--which were causing difficulties. In answer to a question by Mr. Conable, Mr. Balcerowicz expressed his full agreement with the proposed program of Bank assistance to Poland over the next 2-3 years.

3. Speaking in the context of the financial sectors, Mr. Baka thanked the Bank for its vigorous support, and said the issue on the Polish side now was how to quickly absorb the $1.1 billion of commitments so far made. He said the financial sector reforms including the upgrading of the banking sector, would make an important contribution to this end. There were already some 40 banks preparing to begin banking operations, many of them involving foreign private capital. This process would be encouraged by the new Banking Law being prepared.

4. Turning to aid coordination, Mr. Conable said care must be taken to avoid waste and duplication in the use of the large amounts of assistance being offered to Poland. Mr. Balcerowicz agreed there is room for some improvement in this respect, but he saw the recently formed 5-member committee on aid supervision as an important step in meeting this need.

5. Mr. Qureshi asked how the Gulf Crisis had affected Poland and how the Bank might help. Mr. Balcerowicz said estimated revenue losses in 1990/91 will be some $2 billion and there will be a $1.5 billion loss through the terms of trade impact. Domestic gasoline prices were raised by 16-22 percent (depending on the octane grade) as a result of the crisis. Mr. Conable stated that these impacts could affect the Bank's program, and asked that a close contact be kept as events unfold.

6. Mr. Trzeciakowski pointed out that the social costs of the process impacting the Polish economy were rising. There was a need for new job creation, and training so as to reabsorb those who had fallen into open unemployment. He asked for Bank assistance in this area.

7. Turning to the issue of privatization Mr. Balcerowicz said that the way forward was quite clear. Existing state enterprises would be divided into two groups--those to be privatized by the end of next year, and the remainder. The first material step would be by the transformation of the first group of enterprises into Joint Stock Companies, involving the establishment of new Management Boards. It was not intended to impose this process "from the top" but rather to induce it on behalf of the enterprises by wage reform--i.e., abolishing the excess wage tax on enterprises transforming themselves into JSCs. There would be a need for "non-conventional" methods of privatization in order to more rapidly, making a distinction between small companies (of less than 300 employees) and larger companies. Three categories of shareholders are envisaged: small buyers; active investors; and some share of state holdings. A voucher scheme for the population will be part of the process, and there is a clear need for foreign participation. Asked by Mr. Conable if foreign buyers were coming forward, Mr. Balcerowicz replied that there were but not as many as he would like.

8. Mr. Conable asked that the Minister keep in close touch with the Bank to seek whatever assistance might be needed. In responding Mr. Balcerowicz asked if, during the future EFF and SAL discussions, the Bank and Fund could not mount joint missions to do the work. Mr. Conable said this was idea worth pursuing.

Cleared with and cc: Mr. Lari (EM4DR)

cc: Attendees
Messrs./Mmes. Hasan, Blanchi (EMVP)
Zaidan, Thumm [o/r] (EM4DR)
Nouvel (EM4CO); Ablasser (EM4AG); Apitz (EM4IN); Harbison (EM4HR); Montfort (EM4EE); Sood (EM4IE); Bouhaouala (EMTDR); Hinds (EMTTF); Wackman (EMTIE); Pellegrini (EMTIN); Heyneman (EMTPH); Baudon (EMTEN); Roa (EMTPR); de la Calle, Hilton, Hinayon, Lav [o/r], Loos (EM4CO)

IHume:JLoos/cat

Country: POLAND
September 27 at 4:00 P.M.

Delegation: **Prof. W. BAKA, Pres. of Natl.Bank of Poland**
Mr. L. BALCEROWICZ, Minister of Finance

BACKGROUND

- Stabilization program successful in reducing inflation (after being stuck at 5% p.m., may now be around 2% p.m.).
- However, recession is deep (e.g., 30% decline in state industry) and little evidence yet of supply response. Unemployment (presently 4%) could reach 10%.
- Exports up, imports down leading to unexpected trade surplus of $1.8 billion in first half of 1990. Reserves could be up by $3 billion.
- Politically, public support for reform is weakening and the Government is under pressure to ease up on wages and budgets. Much speculation on internal strife within Solidarity.
- Bank approved five projects ($781m) in FY90 plus a SAL ($300m) in July for a total commitment over $1 billion.

POINTS TO MAKE TO DELEGATION

1. **Structural Reforms**: Congratulate the Polish Government on the major accomplishments during 1990, but it is not going to be easy for yet a while.

   The passage of the privatization law marks another step, but legislative action will not yield results by itself. Programs and institutions to implement these reforms need considerable strengthening. What is their view on this aspect? Will the forthcoming elections influence the pace?

2. **Oil Crisis**. Appreciate the many ways this affects Poland, namely reduced deliveries, international prices and hard currency payments for Soviet oil; higher world prices of oil; and trade embargo of Iraq. Additional cost in 1990 could be $320m plus $137m Iraqi "debt moratorium". Impact in 1991 could be $1.7 billion.

   Assure delegation that we are ready to help and have been looking into the nature and timing of our lending operations.

3. **Lending Program**: Ask delegation whether cits omposition fits their needs.

4. **Coordination of Foreign Assistance** where a number of steps have been taken recently but more needs to be done. Our earlier advice: **manage this assistance or it will end up managing you**.

   What is the Government's view on the respective roles of different agencies? More specifically what role do they wish of the Bank in cofinancing.

IF THE DELEGATION MENTIONS:

1. **Debt** and probes the issue of a Bank DDSR operation.
   YOU MAY REAFFIRM our earlier position that
   a. Poland does need some relief from commercial and official debt to restore creditworthiness and growth.
   b. Poland should pursue opportunities at a bilateral level. Difficult for Bank to respond to a hypothetical question as our role would depend on the specific deal, as well as the position of other creditors.

Estimated GDP Growth:	-14.0% (1990)	FY90 Commitments:	$781m
Lending Program:	(FY91-92) $2,400	Disbursements:	$20m

BOARDS OF GOVERNORS • 1990 ANNUAL MEETINGS • WASHINGTON, D.C.

INTERNATIONAL MONETARY FUND
WORLD BANK GROUP
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
MULTILATERAL INVESTMENT GUARANTEE AGENCY

J

Press Release No. 59

September 27, 1990

HOLD FOR RELEASE
UNTIL DELIVERY

Statement by the Hon. LESZEK BALCEROWICZ,
Deputy Prime Minister and Minister of Finance and Governor
of the Fund for POLAND, at the
Joint Annual Discussion

A year ago I spoke here of Poland's extreme economic difficulties. The country was besieged by a vicious combination of hyper-inflation, declining output, and acute shortages. Decades of central planning had severely distorted the price structure and resulted in an inefficient, state-dominated economic system. It was a dramatic situation which required fast, bold, and imaginative action by the newly elected Solidarity Government.

We accepted the challenge and carried out a thorough diagnosis, with the expert assistance of the IMF and the World Bank, for which we are profoundly thankful. We then embarked on a crash legislative program to form a strong legal foundation for the unprecedented operation of reversing a centrally planned economy to a market economy. That reform program, enormous in both its scope and intensity, was launched on January 1, 1990.

We are very well aware of the high stakes. There are no ready, tested, and proven models to be followed. Everything must be introduced, tested, and corrected while being implemented. These operations require unflinching resolve on the part of the Government and great sacrifices on the part of our society. We have both, but we know that the political tolerance of society may be brittle. We are proud of the strong resolve of the Polish people to put their house in order and to accept the costs of economic reform. But the results must show prospects for a better life.

We are doing our best to continue the bold economic reform program essential to the future of Poland and also important to the global reversal toward a market economy which we all praise. We need strong, unflinching, sustained, and innovative support as well as the cooperation of the international economic community.

The Polish reform program consists of two interrelated parts: a stabilization program designed to stifle hyper-inflation and balance the market; and a program of systemic changes designed to produce a modern, competitive, free-market economy. The stabilization strategy, which is being constantly reviewed to ensure that it achieves its objectives, consists of the following basic elements: (a) reduction of the budget deficit, achieved mainly by cutting subsidies; (b) maintenance of a tight monetary policy based on positive real interest rates; and (c) implementation of a tough, tax-based wage restraint policy. At the same time, we initiated a number of important systemic changes:

- We have liberalized prices. The proportion of prices freely determined by the market has risen from 50 percent to 90 percent.

- All administrative rationing of goods and services has been abolished.

- We have reformed the banking system. The Central Bank has been separated from the budget, and a two-tier banking system has been set up. A liberal policy of concessions has allowed for the formation of private banks, and some state banks are being prepared for privatization.

- Competition has been invigorated by a sweeping liberalization of foreign trade, the breaking up of monopolies, and the introduction of a unified and stable exchange rate, as well as convertibility of the zloty for current account transactions. Poland was the first Eastern European country to achieve this.

- Privatization of small companies is progressing. Road transport, which used to be almost totally state-owned, is now 50 percent in private hands. Some 15,000 shops have passed into private ownership, and there are 20,000 more private firms than existed a year ago.

So far, the economic reform program has been progressing encouragingly. The following are just a few positive signs that we are on the road to full recovery. Inflation has dropped from a monthly level of 80 percent in January to 1.8 percent in August. The budget deficit has been reduced from the equivalent of about 8 percent of GDP in 1989 to only 1 percent, and by the end of the year we shall probably have a balanced budget. Massive and widespread shortages that were part of Polish life for decades have been eliminated, and a balanced market is well established. The exchange rate has remained rock-steady for almost nine consecutive months. And, foreign trade has performed well, particularly in hard currency exports which rose by almost a 25 percent in the first eight months of this year.

We are most encouraged by the achievements outlined above. Regrettably, there are painful costs to be borne. Polish society is paying a heavy price for the transition to the market economy. The price of stifling inflation has been recession and a substantial fall in production, though I am pleased to add that the preliminary data for August show a welcomed reversal of this trend. There has also been a significant fall in living standards, with average real incomes down by about 30 percent this year. And unemployment has grown to a current level of about 6 percent. The society accepted the hardships with understanding. Poles understand that things must get harder before they get better. However, in our work we have to consider the necessity of maintaining the confidence of society in the reforms and its tolerance for harsh measures.

We are very apprehensive that just as the Polish economy seems to be showing the first faint signs of recovery, unexpected world events have unfavorably influenced our situation. I am referring first to the Gulf crisis. Poland was active in trade with Iraq, and loss of that export market will bear heavily on our economy. We will also be deprived of oil supplies from Iraq, and the increased world oil prices are a severe blow to our recovery. We are also very unfavorably influenced by the decomposition of the CMEA. The sharp decline of Soviet oil supplies to Poland will also deal a severe blow to the Polish recovery and impose a massive new burden on Poland's foreign exchange. Severe disruptions will also cripple the industries traditionally geared to supply the U.S.S.R. Finally, we welcome the unification of Germany; however, we cannot help but notice the related decline of demand for Polish exports, especially in the engineering industry.

All of these obstacles compound our difficulties now just when Poland is at the crossroads. We are prepared to respond to these new challenges with resolve and determination, but we will need international assistance and understanding, particularly expressed in a lasting and satisfactory solution of the Polish debt burden. We experienced international solidarity in the past, and we sincerely hope this will be the case in the future. The interests of Poland and the world require it.

POLAND

1990 ANNUAL MEETINGS
UPDATE FOR SENIOR MANAGEMENT BRIEF

1. Debt. During the IMF Board review of the Polish Stand-By Arrangement on September 10, 1990, Debt and Debt Service Reduction (DDSR) was discussed by several Directors. While most urged progress in a commercial bank DDSR, the theme on official debt mentioned by France, US, Japan and Germany was that the Paris Club had already given Poland a generous rescheduling and that offical debt remained the purview of the Paris Club. The breakthrough Morocco deal with the Paris Club was not yet public, although it is interesting to note that the French Director did state that any program which might be developed to address the official debt problem for middle income countries should include Poland.

2. At long last, the Ministry of Finance is moving to arrange for assistance from legal experts well versed in commercial bank rescheduling and DDSR techniques. Grant funds are being provided under the Japanese Trust Fund allocation managed by the CFS. As a follow-up to the technical advice provided by CFS missions, CFS has also prepared a report on issues and tradeoffs in the design of a debt strategy for Poland, which will be discussed with the Polish authorities in late October.

3. No formal negotiations are scheduled with the London Club at this time, although Mr. Larkman, Barclays Bank and head of the steering committee, was in Poland last week for discussions. While previously resisting strongly any Brady type deal without parallel concessions from the Paris Club, the London Club position may be evolving depending on the commercial banks' perception of when and how to obtain the best deal.

4. We understand that the Polish authorities are considering requesting formation of a consultative group on development assistance, including external debt relief. No government decision has been taken yet, and the Polish Delegation may try testing the waters for this during their bilateral meetings at the Annual Meetings. We will keep you informed of developments as they occur. Although they have not expressly stated their intentions to do so, we expect the Polish authorities also will wish to learn the World Bank views on potential Paris Club DDSR (especially in light of the Morocco deal). They may also probe further how complete and formalized must be the "overall resolution" of Poland's debt overhang, in order for the World Bank to provide enhancements to a Brady deal for commercial banks.

5. Recommended Position. You may wish to reaffirm our earlier positions that: (i) we consider Poland to need some form of DDSR or equivalent measures from commercial and official sources in order to restore creditworthiness and growth -- a position which has drawn some negative resonses at our and the IMF Boards for moving into issues considered the purview of the Paris Club; and (ii) pending some major shift in Paris Club positions concerning DDSR for high income countries, Poland should take full advantage of the political interest of western official sources to pursue

opportunities on a bilateral basis which may not be forthcoming from the Paris Club as a group, specifically interest rate reductions. As to our position on enhancements for commercial bank DDSR and how concrete the overall creditworthiness scenario must be, you may wish to explain that it is difficult to respond to a hypothetical question, as our potential response depends on the nature of the Brady Plan deal as well as the position of the other creditors at that time.

6. Oil Crisis. The oil crisis affects Poland in several ways: (i) deliveries of Soviet oil and gas are expected to be reduced by about 30% in 1990 and Poland must find substitute sources; (ii) the CMEA trade regime is being unwound faster than originally planned and starting in 1991, Poland will need to pay at international prices and in hard currency for Soviet oil and gas; (iii) Poland extended a $500M loan to Iraq which was to be repaid in the form of oil deliveries, now suspended due to the blockade; and (iv) international oil prices are increasing. The additional cost in 1990 of higher oil import prices is estimated to be about $457M or about 4.6% of 1989 exports or 0.7% of 1989 GDP, including the cost of the Iraqi "debt moratorium" of about $137M.

7. Under the assumption that, starting January 1991, all oil will be acquired at world prices and for hard currency, the cost of the oil price increase (over and above earlier price projections) would be about $1.7B in 1991. This represents about 18% of 1989 exports or about 1.9% of 1989 GDP. We will be discussing these issues, revisions to balance of payments forecasts and financing plans, as well as the potential impact on the Bank's proposed lending program during Regional Management and other consultations with the Polish Delegation at the Annual Meetings, as well as during the forthcoming SAL supervision mission in October.

8. Recommended Position. You may wish to assure the Polish delegation that we are looking carefully at the nature and timing of our proposed lending operations and are ready to discuss with them how best we can support their own programs to meet these additional financial and institutional burdens.

9. Political Developments. After the August Parlimentary recess, political developments are heating up again in September. A major "summit" of political leaders is underway, at which they hope to forge an agreement on key issues, including the timing of the next Presidential and Parliamentary elections and constitutional amendments to elect directly the President (currently he is elected by the combined upper and lower houses of Parliament), increase his powers, and establish the electoral system for Parliament (proportional or first past the post). Mr. Walesa has already announced his candidacy for President. Speculation ranges widely about the possible outcomes, and it is not excluded that the Mazowiecki government would resign and a new one be formed. The Solidarity faction supporting the Mazowiecki government has made known its concerns that a plunge into a major redefinition of Presidential versus Parliamentary powers, another round of elections and formation of another government would prolong institutional uncertainties and divert scare time and attention from the economic reform. That faction aligned with Mr. Walesa is concerned that the democratization process has stalled, with a Parliament (and, indirectly, a government) and a President not truly

representative of the Polish people. We will provide more information about these matters as they are known in time for your meeting with the Polish delegation.

10. Operations Programming. At the time the briefings were prepared, we expected to hold discussions with the Polish authorities in Warsaw in October to establish a sound work program for World Bank assistance. These meetings have been rescheduled to start right after the close of the Annual Meetings on September 28, 1990. These discussions will be pursued thereafter by follow-up missions and the Resident Mission. Issues to be discussed include responses to the request by the new Minister of Ownership Change for additional support from the World Bank for work on privatization. New Ministers were also appointed for Agriculture and for Telecommunications, both areas where we expect to have significant involvement in the near future.

11. Corrections. The briefing note sent in early September contained an error in the total volume of lending so far approved; the total for the five projects approved in FY90 is $781M. With the approval of the SAL at end July, 1990, our total commitments to date are $1081M. Four loans are already effective; arrangements for effectiveness of the remaining two are in the process of completion.

JLoos
c:\wp50\doc\update

SENIOR MANAGEMENT BRIEF

1990 ANNUAL MEETINGS BRIEF

POLAND
August 30, 1990

Meeting with: Prof. W. Baka, President of National Bank of Poland and World Bank Governor; and Mr. L. Balcerowicz, Minister of Finance and IMF Governor

Population: 37.9m (Dec 1988); Estimated Growth Rate: 0.77%
GNP per capita: $1760 (1989)

	($m)		($m)
Total Commitments to date:	1081	FY90 Commitments:	781
of which:		Disbursements:	20
Bank (no. of operations and value)	1081 (6)	Amortization:	0
IDA (no. of operations and value)	-		
Total Undisbursed:	1061		
Lending Program: FY91-92	2400		

Summary Data	Average 1985-89	EST. 1990	
GDP growth	2.9%	-14.0%	Aid Group Meeting: NA
Export growth	2.2%	5.7%	Last Meeting: NA
Import growth	4.3%	-15.0%	IMF Status as of: (8/90)
Current Account Deficit (% GDP)	-1.3%	-0.5%	Standby (80% of quota)
Gross Debt Service Ratio-owed	82.9%	69.8%	conditions being met
-paid	23.1%	17.4%	
Annual Inflation Rate	137.6%	550.0%	

Background:

1. Political: Solidarity movement fracturing, Government without clear political mandate; uncertain how long society can tolerate high costs of adjustment.

2. Economic: Stabilization successful in bringing down inflation and clearing markets, however, recession deeper than anticipated. Lack of supply response (pending structural reforms) complicating social and economic policy.

3. Bank Operations: Over $1b committed in last six months; pipeline of projects addressing key policy areas under preparation for second half FY91.

Issues likely to be raised by delegation:

1. Bank support for negotiations with London and Paris Clubs
2. World Bank Lending Volume and Composition

Issues to be raised by Bank Management:

1. Pace of Structural Reforms and Bank Lending Program
2. Coordination of Foreign Assistance

Attachments:

Five-Year Lending Program: FY91-95 (FY90 actual)
Biographical Information

BACKGROUND

1. Political. Public support for the reform is weakening, although approval ratings are about 60%; Prime Minister Mazowiecki's personal approval rating is still over 80%. Public confidence in politics (always low) is being battered by infighting within Solidarity forces and the time-lag between reforms and positive results. There appears to be a concensus to hold Parliamentary elections early in 1991, followed by the replacement of President Jaruzelski (President is elected by the Parliament).

The Government is under strong political pressure to ease some of the strict stabilization conditions (e.g., wages, budgets) in the second half of 1990 to reduce the immediate burden on the population and moderate the recession. It appears that the Government will be able to put forward the 1991 budget, but implementation will depend on the election results.

2. Economic. The stabilization program brought down the rate of inflation to about 4% per month, but the recession is deeper than anticipated (30% decline in industrial socialized sector output in first half 1990). Second half targets call for some moderation of the recession leading to fullyear drop of about 15% in GDP. Unemployment is currently about 4%, and could easily reach 10%. Exports have responded well, with imports down more than expected, leading to an unexpected trade surplus of $1.8b in first half, more than achieved for full year results in past; reserves could increase by more than $3b.

ISSUES

Part I: Issues Likely to be Raised by the Delegation

1. (a) Bank Support for Negotiations with London and Paris Clubs: (TO BE UPDATED WHEN WE KNOW WHAT THEY WILL ASK SPECIFICALLY).
Our economic work indicates that Poland would not be able to restore creditworthiness (measured by conventional standards) without major debt and debt service reduction (or equivalent measures) by both commercial and official creditors. We included this analysis in the SAL documentation, and although the conclusion was not questioned, US, France and Japanese EDs objected to the World Bank intervening in Paris Club matters.

The Polish authorities have initiated discussions with the London Club about a Brady type of deal and a special subcommittee of the Paris Club was formed to look into ways to assist Poland. The commercial banks are resisting moving very far without comparable concessions from the Paris Club, as they (correctly) have pointed out that a Brady Plan deal alone would not be sufficient to restore Poland's creditworthiness. The Paris Club is reluctant to set a precedent with Poland on debt reduction, and has suggested that means be found within the bilaterally negotiated terms (e.g., interest rates, additional concessional lending).

(b) Recommended Position: You may wish reiterate our previous advice that the two negotiations should not be separated and that the Polish authorities prepare the case for Paris Club concessions by stressing the unique circumstances of the Polish case, the courageous introduction of radical reforms, and the substantial economic and social costs being incurred.

You may also wish to restate our position that we are willing to assist with a Brady Plan deal, provided it is part of an overall arrangement which restores Poland's creditworthiness. Suitable vehicles are available in the lending program for set asides and a free-standing operation could be mounted if needed. As to specific support on the Paris Club negotiations, you may wish to explain that, although there are some financial engineering aspects on which we could offer assistance, this is more a political than a technical matter. You may wish to reiterate our long-standing offer to help arrange this sort of strategic assistance.

2. (a) World Bank Lending Volume and Composition. The Polish authorities have expressed keen interest in receiving additional policy-based, quick disbursing loans, making up a significant share of the US$2.5b lending program potentially available to Poland. While in many cases, there is significant policy conditionality being discussed for several programs under preparation, we could not accommodate all such requests and stay within Bank norms. We could accommodate about one-two such operations a year, assuming the overall balance of payments need is established.

(b) Recommended Position: You may wish to explain that the share of policy-based, quick disbursing operations is not likely to be above 25% of our total lending each fiscal year, and that an overall balance of payments need must be evident and each project case made on its own merits. You may wish to explain that we would continue to work on sectoral and reform issues in the context of investment projects, which are also useful vehicles to attract and put to good use some of the significant external resources potentially available to Poland. You may wish to remind the Polish authorities that we are looking forward to the planned review of the Polish lending program in October, to discuss and reprogram as necessary the overall lending program and priorities for policy-based, quick disbursing operations.

Part II: Issues to be Raised by Mr. Conable (Mr. Qureshi)

1. (a) Pace of Structural Reforms and Bank Lending Program: With the passage of the privatization law, another important ingredient of reform is falling into place. However, as with other reforms, legislative action does not automatically lead to results. Polish efforts need to be strengthened to design and staff-up programs and institutions to put these reforms into action. Until such programs and institutions are in place, the positive results of the economic reforms will not be forthcoming and Poland will not be in a position to draw usefully on the considerable international financial resources available to it.

Five project loans, totalling US$531 million, have been approved thus far in 1990. Of the two effective loans US$20 million have been currently disbursed. This initial pace of disbursement is probably due to the slow supply response of the economy, combined with some uncertainty that discourages borrowing and some lack of familiarity with loan procedures. Additionally, we are preparing a series of projects to assist with structural reforms, following-up the recently-approved US$300m SAL. Financial Institutions Development, Industrial Restructuring, Employment Services projects pursue institutional objectives in the three main policy components of the SAL; energy sector projects support responses to energy pricing reforms. As substantial preparatory work needs to be completed before projects can be mounted, it is likely that our next round of lending will not be ready until the second half of FY91.

(b) Recommended Position: You may wish to congratulate the Polish authorities on the major accomplishments of the last six months, and caution them that it is not likely to get any easier for a while. You may wish to inquire about their views on the pace of development of programs and institutions to implement the reforms (specifically those for privatization) and the influence of forthcoming elections on this work. You may wish to inquire about their views on how World Bank lending proposals fit within their current plans.

2. (a) Coordination of Foreign Assistance. A number of steps have been taken by the Polish authorities to improve aid coordination. The Government recently reorganized its aid coordination arrangements, increasing the direct involvement of the Ministry of Finance. A UNDP-sponsored technical assistance project is being readied to assist with associated institutional arrangements. While much needed, these efforts do only part of the job. An area not yet adequately covered is strategic planning of the major sources of foreign assistance -- World Bank, EIB, EC, and EBRD. The World Bank and the EC have established offices in Warsaw and the EBRD is expected to follow suit. In the meantime, ad hoc deals are being arranged--e.g., EIB cofinancing of two World Bank-appraised projects, EBRD requests to look over World Bank lending pipeline, joint World Bank-EC consultations on financing needs, EC funding of technical assistance under World Bank-financed projects.

(b) Recommended Position: You may wish to inquire about the Polish authorities' views on the respective roles of these organizations, and specifically about what role they wish the World Bank to play in cofinancing. You may also wish to reiterate our earlier advice that unless the Polish authorities manage this assistance, it will end up managing and possibly mis-managing them.

POLAND

FY91-95 Lending Program
(in $ million)

	Actual FY90	FY91	FY92	FY93	FY94	FY95	FY91-95 Sector Total
Agriculture							
Agro-Industry	100						
Ag. Development I		100					
Ag. Development II			175				
Rural Infrastructure					100		
Land Development					200		
Ag. Credit					100		
(Sub-total)	(100)	(100)	(175)	(-)	(400)	(-)	(675)
Infrastructure							
Transport I	153						
Transport II						150	
Infrast. for Exports			150				
Telecomm. I		100					
Telecomm. II				100			
Housing I			200				
Housing II					100		
Municipal Infrastructure					200		
(Sub-total)	(153)	(100)	(350)	(100)	(300)	(150)	(1000)
Industry							
Ind. Export Devl.	260						
Ind. Restr. I		200					
Ind. Restr. II				200			
Ind. Restr. III						200	
SME Development			175				
Industrial Services				100			
(Sub-total)	(260)	(200)	(175)	(300)	(-)	(200)	(875)
Energy							
Energy Res. Devt.	250						
Heat Supply Restr.I		200					
Heat Supply Restr. II					200		
Power Supply Restr.I			200				
Power Supply Restr. II						200	
Energy Conservat.				150			
(Sub-total)	(250)	(200)	(200)	(150)	(200)	(200)	(950)
Environment							
Environment Mgt.	18						
Environment I			150				
Environment II				150			
Environment III					150		
(Sub-total)	(18)	(-)	(150)	(150)	(150)	(-)	(450)
Structural Adjustment							
SAL I		300					
SAL II				300			
SAL III						300	
(Sub-total)	(-)	(300)	(-)	(300)	(-)	300	(900)
Other							
Fin. Inst. Devl.		150					
Financial Sector				100			
Employment Services I		150					
Employment Services II						150	
Health			150				
Technical Educ.					50		
(Sub-total)	(-)	(300)	(150)	(100)	(50)	(150)	(750)
Total	781	1200	1200	1100	1100	1000	5600

Aug. 30, 1990
EM4CO

Attachment II

POLAND

BIOGRAPHICAL INFORMATION

Professor Wladyslaw Baka, President of National Bank of Poland and World Bank Governor.

Born March 24, 1936 in Warsaw. Married.

Graduated in 1959 from the University of Warsaw and has since been a member of the Faculty. Received his Ph.D in Economics in 1971.

September 1989: Reappointed President of the National Bank of Poland, a position he also held from July 1985 to June 1988.

Professor Baka was a prominent member of various governments since the major reforms were initiated after martial law in 1981. In addition to President of the National Bank, these positions include Minister of Economic Reform and Member of the Cabinet; he also served as a member of the Communist Party Politburo and was a Secretary of the Central Committee. He is a strong supporter of the Economic Transformation Program and has taken a special interest in financial sector reform. His political future is unclear, as holdovers from previous regimes are being removed from office.

Speaks French and, somewhat haltingly, English.

Mr. Leszek Balcerowicz, Deputy Prime Minister and Minister of Finance and IMF Governor

Age 43 Married, three children

Graduate of Main School of Planning and Statistics, Foreign Trade Department. PhD of Economics.

September 1989: Named Deputy Prime Minister and Minister of Finance in the Mazowiecki government.

Mr. Balcerowicz is the major force defining and pressing ahead with the reform and adjustment programs underway in Poland. The stabilization program is publically identified with his name. He is a very bright and able man, who is keen to obtain the best advice possible; Bank missions have had good access to meet with him when needed, although he is clearly overburdened.

Mr. Balcerowicz was a member of the Polish Communist Party until 1981; he is now a member of Warsaw Civic Solidarity Committee.

Speaks good English

Date: August 30, 1990

1613

ANNUAL MEETING BRIEF - 1990 - IFC

POLAND
(Member since 1990)

Representing Poland:

Mr. Leszek Balcerowicz, Deputy PM and Minister of Finance.
Mr. Stefan Kawalec, Director General, Ministry of Finance

Key Points:

1. FY90 Program realized was two projects approved: Export Development Bank Agency Line (DM50 million) and Bristol Hotel ($8.7 million). Extensive effort was spent on technical assistance and advisory service activities, particularly on the legislative and organizational framework for banks and the privatization program, and helping mobilize technical assistance funding from external sources (for privatization and foreign investment agencies).

2. FY91 project pipeline is promising including some large deals, Asahi and Kvaerner Gdynia, under appraisal (with Fiat likely for next year) which, with reasonable expectation, could materialize in some $75 - 100 million in new investment approvals for IFC in FY 91. Mobilization of external resources, particularly commercial bank loans under IFC umbrella is an important objective to be pursued. As in the case of Hungary, we are likely to move to mortgage based lending, from local bank guaranteed loans, with attendant higher risks and rewards (spreads) for IFC.

3. Establishment of SME Business Advisory Service (Project Development Facility) is at the top of the list of our t.a. activities for this fiscal year. Draft Board paper has been shown to the Ministry of Finance which supports the initiative. Government support for mobilizing grant funding for service should be reconfirmed during meetings, particularly the resources for SME development available from the European Community.

4. Privatization Program: The status of the government's program (which a CFS mission assisted in drafting) could be ascertained at the meeting. Indications are that the Minister of Privatization may not be appointed soon because of differences between Welensa and Mazowiecki factions. This could slow down the program implementation. Government is keen to use IFC as significant institutional investor with active role on boards of privatized companies and to help promote portfolio investments through country funds for foreign investment and mutual funds for local investment.

   For rapid privatization of larger firms, government's thinking is to have several investment banks each handling 10/15 deals at a time. IFC views on this may be sought at meeting. CFS currently in process of cherry picking for deals it could undertake. CFS already has mandate for privatization of a furniture company (assignment underway). In connection with the privatization program Government may wish to discuss D/E swaps, a paper on which was earlier provided by IFC to Balcerowicz.

5. Capital Markets. Poles likely to use French Bourse to set up and manage stock exchange but want IFC on Supervisory Board. Poles will also want an update on J.V. commercial bank, creating insurance companies, leasing operations and technical assistance for local commercial banks (Kuczynski).

6. Portfolio: This now consists of three projects Hortex, EDB and Bristol for total IFC investment of around US$52 million. The Cooperative parent company of Hortex is legislated for liquidation. The Government appointed liquidator's competence (for coming up with a sensible restructuring plan) is an issue flagged to the Government by IFC. Liquidator has so far rejected IFC assistance but we are following up. The Hortex loan is guaranteed.

7. IFC Pipeline (US$ million)

	IFC Financing		
	Gross	Net	Status
Asahi Glass	36+	36	Under Appraisal
Gdynia Shipyard	200	50	"
Sanok Auto Components	9	9	"
JV Commercial Bank	3.2	3.2	"
Fiat Cras/Engine Complex	X100	100	Under Preparation
Basznia Sulphur	10	10	"

In addition, Winterton's work on the Privatization Foundation is continuing, CFS has project for privatization of a furniture company and a few other projects are under preliminary discussion.

September 10, 1990

POLAND
1990 Annual Meetings Brief

Prof. Wladyslaw Baka, President of National Bank of Poland and WB Governor

-Age 54; Faculty of University of Warsaw;

-President NBP 85-88, reappointed Sept 89.

-Prominent member of various governments since 1981, including Minister of Economic Reform and Member of the Cabinet;

-Member of the Communist Party Politburo and Secretary of the Central Committee.

-Strong supporter of Economic Transformation Program, active in financial sector reform;

-As holder from previous regime, political future uncertain.

-Speaks French and some English

Mr. Leszek Balcerowicz, Deputy Prime Minister and Minister of Finance;

-Age 43; Graduate of the Main School of Planning and Statistics, Foreign Trade Department.

-Sept. 1989 named Deputy Prime Minister and Minister of Finance

-Major force in defining and pushing reform and adjustment program.

-member of Communist Party until 1981; now member of Warsaw Civic Solidarity Committee.

Recent Political Developments:

-Solidarity has fractured, Government is without clear political mandate, uncertain how long society will tolerate high costs of adjustment.

-Political support for reform weak, but Government approval rating still 60%, with rate of PM, Mazowiecki, over 80%.

-Infighting in solidarity and no positive results from reforms creating pressure to wages, budget restraints.

-Parliamentary elections likely early in 1991, followed by choosing of new president.

-Implementation of 1991 budget depends on elections.

-Speaks good English.

Recent Economic Developments:

-Stabilization successful in attacking inflation, but recession and lack of supply response reducing ability to maintain policies.

-Stabilization program brought inflation down from 60% per month to 4%.

-30% decline in industrial social sector output deeper than anticipated;

-unemployment reached 4% in July, and could easily reach 10% by early 1991.

-Exports up and imports down, resulting in $1.8 billion trade surplus for first 6 months, double previous showing.

-World Bank states openly that Poland unable to restore creditworthiness without major debt and debt service reduction by both commercial and official creditors. WB pressing for concessions for Poland.

-Privatization law passed at end July; Implementation program under debate.

MIGA - ANNUAL MEETINGS BRIEFS

The following issues related to MIGA, which you may wish to raise in your meetings with delegations. In summary:

(a) Non-member countries would be encouraged to sign and/or ratify the MIGA Convention;

(b) Some countries would be asked to complete their subscription payments promptly; and

(c) Other countries would be asked to give favorable considerations to facilitate MIGA operations.

Poland

We presently have 19 active applications, of which two are at an advanced stage. We expect to submit for your approval one of these, ABB, by the time of the Annual Meetings.

file → Poland

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: July 31, 1990

NAME	ROOM NO.
Mr. Barber Conable	E 1227
AK has seen	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		URGENT

REMARKS:

I brought this from Poland for you.

FROM:	ROOM NO.:	EXTENSION:
Alan Gelb	N 6037	37667

The World Bank
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.

(202) 477-1234
Cable Address: INTBAFRAD
Cable Address: INDEVAS

Poland Resident Mission
c/o Marriott Hotel, Suite 4021,
Warsaw

18 July 1990

Mr. Barber B. Conable
President
The World Bank
Washington, D.C. 20433
U.S.A.

Dear Barber:

Thank you for your kind note which I received by pouch some days ago.

Getting the Warsaw office underway has been something of an adventure, marked by a conglomerate of practical problems some of them to be expected, others not. This week will see the full installation of all the furniture, office technology and telecommunications equipment - some three weeks behind schedule, but nevertheless a fair achievement in the circumstances.

Meanwhile, critically important events unfold in government, almost on a daily basis. As you will now have read, the Privatization Bill was passed into law this week establishing another major milestone on Poland's committed journey to a free commercial economy.

The Bank's presence here is being very well received and though our work has really hardly begun, there is a clear eagerness on the part of our interlocutors to engage us in all major issues of the day (of which there are a good number).

Thank you for the generous comments you made in your note. All of us in the Warsaw office team are excited and challenged to be here, at this time and it is our intention to do all we can to make a contribution worthy of the sound decision to establish the mission in Poland.

We hope to show you the fruits of that when next you pass the country and visit.

With kindest regards,

Yours sincerely,

Ian Hume

Ian M. Hume
Resident Chief of Mission, Poland

ITT 440098 RCA 248423 WUI 64145

Y-7040

Mr. Barber B. Conable
President
The World Bank
Washington, D.C. 20433

Multilateral Investment Guarantee Agency
Washington, D.C. 20433, U.S.A.

BARBER B. CONABLE
President

July 25, 1990

Dear Mr. President:

It gives me great pleasure to welcome your appointment as the first Alternate Governor for the Republic of Poland on the Council of Governors of the Multilateral Investment Guarantee Agency. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position to actively participate in the affairs of the Agency, as well.

On behalf of the Directors, Officers and Staff, I congratulate you on your appointment and thank you for your willingness to take on this additional responsibility.

I look forward to meeting you in the near future, and send my best personal wishes.

Sincerely,

Barber Conable

Mr. Zbigniew Piotrowski
President
Foreign Investment Agency
Pl. Powstancow Warszawy
00-950 Warsaw
Republic of Poland

Multilateral Investment Guarantee Agency
Washington, D.C. 20433, U.S.A.

BARBER B. CONABLE
President

July 25, 1990

Dear Mr. Deputy Minister:

It gives me great pleasure to welcome your appointment as the first Governor for the Republic of Poland on the Council of Governors of the Multilateral Investment Guarantee Agency. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position to actively participate in the affairs of the Agency, as well.

On behalf of the Directors, Officers and Staff, I congratulate you on your appointment and thank you for your willingness to take on this additional responsibility.

I look forward to meeting you in the near future, and send my best personal wishes.

Sincerely,

Barber Conable

Mr. Janusz Sawicki
Deputy Minister of Finance
Ministry of Finance
Swietokrzyska 12
00-044 Warsaw
Republic of Poland

1) ~~AK~~

~~2) SS~~

cc: SS 6/21/90

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 90/06/19 DUE DATE : 00/00/00
LOG NUMBER : 900620006 FROM : Mr. Stanley Fischer
SUBJECT : Re - Germany and Indonesia: Precedents for Poland?

OFFICE ASSIGNED TO FOR ACTION : 3) Mr. B. Conable (E-1227)

ACTION:

	APPROVED
	PLEASE HANDLE
✓	FOR YOUR INFORMATION
	FOR YOUR REVIEW AND RECOMMENDATION
	FOR THE FILES
	PLEASE DISCUSS WITH ______
	PLEASE PREPARE RESPONSE FOR ______ SIGNATURE
	AS WE DISCUSSED
	RETURN TO SP/Maria (file)

COMMENTS :

The World Bank
Washington, D.C. 20433
U.S.A.

STANLEY FISCHER
Vice President Development Economics
and Chief Economist

June 19, 1990

Mr. Conable

Barber,

Re: Germany and Indonesia: Precedents for Poland?

Following the February 1990 agreement with the Paris Club on rescheduling of principal and interest payments, the Polish government has argued that it needs a more permanent solution, and has pointed to the 1952 agreement on German debt as an example of the type of deal it may seek. The German settlement, however, does not present a clear precedent for Poland since the reduction in economic performance by Germany due to the World War and the reduction in geographic territories resulted in a strong case for official debt forgiveness. A better precedent is Indonesia which reached agreements with its official creditors between 1966 and 1970 that resulted in substantial amounts of debt relief. The attachments provide more description of these two agreements.

Stan

Stanley Fischer

Att.

c.c. Messrs. Qureshi, Stern, Thalwitz, Shihata, Kashiwaya, Wood, Wapenhans

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 18, 1990

TO: Mr. Barber Conable

FROM: Stanley Fischer SF

EXT: 33774

SUBJECT: Germany and Indonesia: Precedents for Poland?

1. On February 16, 1990, Poland reached agreement with the Paris Club on a rescheduling of all interest and principal payments falling due in 1990 and the first quarter of 1991. The payments were rescheduled with an eight year grace period and 14 year final maturity. In addition, arrears built up by Poland with Paris Club countries were also rescheduled, bringing the total amount rescheduled to $9.4 billion, which can be compared to a debt stock owed to Western official creditors of $27 billion.

2. The 1990 Paris Club agreement provided Poland with important temporary debt relief. The Polish government has argued subsequently that it needs a more permanent solution, and has pointed to the 1952 London agreement on German debt as an example of the type of deal it may seek. This note briefly summarizes the 1952 German agreement, as well as agreements Indonesia reached with its creditors between 1966 and 1970. (Notes providing more details on these two agreements are attached).

3. The 1952 settlement of the German pre- and postwar claims resulted in a 40 to 50% reduction of its total foreign debt burden. The German settlement does not present a clear precedent for Poland since the reduction in economic performance by Germany as a result of the World War and the reduction in geographic territories resulted in a strong case for official debt forgiveness. This, probably together with a recognition by the creditors that Germany's interwar debts were increased as a result of the heavy post-WWI reparation demand on Germany, made the official creditors more willing to provide relatively generous concessions to Germany.

4. The 1966-1970 Indonesian agreements present more similarities with the current Polish situation: in both cases the external debts were incurred under different political regimes and had yielded limited economic benefits. The terms of the recent Poland Paris Club rescheduling are comparable to the agreements reached between Indonesia and its official creditors over the years 1966-1969: no principal reduction, but reschedulings of all payments falling due at originally contracted (or somewhat lower) interest rates. For Poland a rescheduling of all principal and interest payments falling due to Western official creditors in 1991 and 1992 would imply cash flow relief in both years of about $1.3 billion. In 1970, Indonesia reached a final agreement with the Paris Club which rescheduled all debt (including previous rescheduled payments) on very generous terms (30 year maturity and zero interest rate). It is estimated that this agreement reduced the present value of Indonesia's official debts by about 60%. For Poland such a concessional consolidation of all official claims in 1993 (after reschedulings in 1991 and 1992 of principal and interest payments), would imply annual cash flow relief in 1993 and thereafter of about $1.2 billion.

Attachment
cc: Qureshi, Stern, Thalwitz, Shihata, Kashiwaya, Wood, Wapenhans

P-1867

The 1952 German Debt Settlement in London

1. The initial impulse for the settlement of German pre- and postwar debt originated on the side of the Allies. The Occupation Statute of 1949 contained reference to external claims against Germany. Negotiations between the governments of the UK, France and the US and the government of the Federal Republic of Germany (FRG) opened in 1950. The approach to the final discussions was cleared when the three governments reached agreement with FRG in October 1950 (in the form of a Memorandum from the three governments) that concessions would be provided in the settlement of their claims in respect of their postwar economic assistance to FRG, provided an equitable settlement of prewar debt was reached. It was agreed that the debt would be renegotiated to ensure that FRG could meet its obligations and to help it return as soon as possible to creditworthiness. In the settlement of the prewar debt, account would be taken of the limitations on FRG territorial jurisdiction and its capacity to pay. The settlement plan was expected to take into account the general economic position of the FRG, notably the increase in its burdens and the reduction in its economic wealth, and not unduly drain its foreign exchange resources or have undesirable effects on its internal financial situation. In an exchange of letters between the governments of France, the UK and US and the government of FRG on March 6th 1951, Chancellor Adenauer recognized, subject to these reservations, responsibility for the prewar external debt of the German Reich.

2. In May 1951, the three governments set up the Tripartite Commission on German Debts. The Commission held preliminary discussions in June and July 1951 with the German Delegation on External Debts. In December 1951 the Tripartite Commission informed the German Delegation of the amounts and terms of payments which the three governments were prepared to accept in full settlement of their claims in respect of postwar economic assistance, provided a satisfactory settlement of the prewar debt was achieved. As a next step, the 1952 London Conference was called by the Tripartite Commission on German Debt to work out a general agreement for the settlement of German external debt.

3. The Conference opened on February 28, 1952. At that time, the outstanding external debt of Germany was about \$6.8 billion, consisting of about \$3.1 billion of prewar debt and about \$3.7 billion of postwar debt. The prewar debt consisted in large part of tranches in different currencies of the Dawes and Young loans.[1] Of the prewar debt approximately \$1 billion consisted of accumulated arrears. An important aspect of the prewar debt was that the creditors were protected against a depreciation of their <u>own</u> currency through a gold clause which required payment in gold coin (of the US).

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[1]The Dawes loan emerged from an American plan to deal with the external debt problem (reparations) of Germany after WWI, was extended in 1924, and was floated in the US and several European countries. The Young loans were extended in 1930 in the context of an attempt to achieve a final settlement of the German reparations. Both loans were issued in various currencies and traded on foreign exchanges.

4. The opening posture of the FRG was that FRG's debt should be scaled down by 40 to 50% on account of loss of territory and economic capacity. In the subsequent negotiations at the conference FRG made an offer to pay $119 million annually in amortization and interest (or approximately 0.34% of Germany's gross national income of $35 billion in 1953), which amount could be increased to $143 million upon improvement of the balance-of-payments situation. This offer amounted to a lowering of the effective interest rate on the originally contracted debt to about 2 percent. Creditors flatly rejected this offer. A short time later, a final compromise was reached with the creditors which stipulated that FRG was to pay $132.2 million during the first five years. The offer involved larger payments on prewar debt than originally offered by FRG ($80.7 million on prewar, rather than $40 million originally offered, and $51.6 million on postwar debt), which was made possible by a postponement by the US of amortization payments by five years. After 1957 payments would be stepped up to $175.2 million. In addition, FRG would pay to Israel and Switzerland in the first five years annually a total sum of $78 million and thereafter $72 million. These transfers amounted in total to about 10% of FRG's total exports in 1952. Total debt service was reduced by approximately 40 to 50% and the debt relief due to the postponement of amortization payments at low interest rates was large.

5. In the absence of any precedents and with the view of restoring FRG's credit standing, the final agreement involved no scaling down of prewar debt.[2] While there was no reduction in the principal amount of prewar debt, the reduction of the total foreign debt (service) burden was accomplished through other concessions made by creditors on prewar and postwar debt. Specifically, the creditors made the following concessions:

a) Postwar debt was reduced from $3.8 billion to $1.5 billion. The US was the largest contributor and reduced its claims--arising from assistance provided in the context of the Marshall plan--from $3.2 billion to $1.2 billion, lowered interest rates to 2 1/2 % and changed the terms to 5 years grace and 35 year final maturity. The reduction on the part of the US was comparable to the treatment accorded other Marshall countries in respect of postwar aid. Lesser concessions were made by the European creditor countries.

b) Interest arrears, which had accumulated since 1936, were reduced for both government and private debts by about one-third. Interest arrears on Dawes and Young loans were calculated at lower than original rates.

c) The rate of interest on most government and corporate loans was reduced by about one-fourth of original contracted rates. On the Dawes loan the rate was lowered from 7% to 5 1/2% for the American issue and to 5% on other issues. On the Young loan the rate was lowered from 5 1/2% to 5% on the American issue and 4 1/2% on the

[2] Payments on some accrued arrears on the Dawes and Young loans and on bonds issued by the State of Prussia were, however, deferred until after unification.

other issues.[3]

d) Maturities were extended and final amortization was postponed by 10 to 25 years. Generally speaking, grace periods exceeded 6 years.

e) The largest single concession regarding prewar claims concerned the replacement of the gold clause by a dollar clause. The gold clauses were initially inserted in loan agreements to protect the lenders against depreciation of their own currency. The gold clause required payment in gold, whereas the dollar clause required payment in dollars. From the period of contracting of the loans till 1952 the dollar had depreciated by about 40% against gold, while the European currencies (with the exception of the Swiss franc) had depreciated by much larger percentages. The substitution of the dollar clause for the gold clause meant therefore that all claims were reduced by approximately 40% (the rate of depreciation of the dollar against gold) from the amounts Germany would have had to pay if the gold clause had been honored. The dollar clause benefitted the European creditors relative to the US since their currencies had depreciated against the dollar. This was compensated for by the lower interest rate on European currency tranches of the Dawes and Young loans.

6. The debt agreement was finalized on February 27, 1953. The terms were in general favorably received in the European creditor countries. Commercial credit lines were restored following the agreement, with some specific arrangements for arrears and new terms, after being frozen since 1931.

7. The internal transfers necessary for servicing the restructured claims did not present a problem for FRG. On the contrary, Germany had continued to service her foreign debts in local currency for many years after she had discontinued external servicing. The external transfer problem appeared severe, however, particularly since it required the generation of a dollar surplus. FRG had usually had a current account surplus with respect to Europe and a deficit with respect to the US. The gap with the US was expected to be closed through NATO defense expenditures, loans from IBRD and US Exim bank, allowing FRG, together with the surplus vis-a-vis her European creditors, to fulfill her obligations.

8. Proposals for flexible arrangements were not well received by creditors. The settlement was therefore largely uncontingent, with the exception of provisions for consultation with creditors in case FRG would find itself faced with difficulties in carrying out its obligations, as a result of internal or external factors.

9. As of March 1960, FRG's external debt associated with the London agreement amounted to $2 billion, down from the $3.1 billion immediately after the agreement. Of the $1.1 billion repaid during the period 1953-1960, a substantial fraction was prepaid, especially on bonded loans and private debts, and advance payments were made to the US, UK and France on postwar debts. The Dawes and

[3]One should note, however, that market interest rates had fallen sharply between the 1920s and 1953.

Young loans appreciated substantially in price from 1953 to 1958 (from between 10 and 20 to around 100 in 1958) and were quoted above par at foreign stock exchanges in 1959 (at 104). Large amounts of external bonds--especially of the government of FRG, were repatriated during this period. In the end, FRG repaid its restructured debts substantially ahead of schedule.

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Harry C. Wallich, "Mainsprings of the German Revival," New Haven Press, 1955.

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The Economist, various issues, 1952.

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WP/Poland.dbt

<u>Indonesia: Debt Reschedulings, 1966 through 1970</u>

1. By the end of 1965 Indonesia was in arrears with respect to part of its external creditors. In July 1966, following an abortive coup in September 1965, the Suharto administration assumed responsibility for affairs and the system of state control established under President Sukarno was slowly being abolished. A balance of payments crisis emerged in 1966 when a current account deficit of $248 million combined itself with debt payments falling due of $530 million. Rescheduling negotiations were held between western creditor countries and the Government of Indonesia (GOI) in 1966 in the context of the Paris Club. Parallel, bilateral negotiations were held with USSR and other Eastern European creditors. The total debt of Indonesia around the time the reschedulings took place stood at $2.2 billion, of which about 35% was due to Paris club countries, 60% to USSR and East-European countries, and the remainder to other countries.

2. Through the Paris Club GOI reached an agreement in 1966 with its Western external creditors. Specifically, the agreement resulted in the following:

a) All debt incurred during the Sukarno regime with a maturity of more than 180 days was included.

b) All Western creditors were treated equally, and there was no discrimination with respect to the original purpose for extending the credit (development or military), and no discrimination between guaranteed and unguaranteed loans.

c) The agreement resulted in a rescheduling of 90% to 100% of interest and principal payments falling due to Paris club countries in the years 1966 and 1967 related to credits effective prior to July 1, 1966.

d) The new terms were 3 year grace, 12 year final maturity, and 3% interest rates (equal to or somewhat below the originally contracted rates). Interest was not payable during the grace period and was not compounded.

3. Further meetings were held with Paris Club countries in October 1967 and October 1968 to consider debt service falling due in the years 1968 and 1969. In general, payments were rescheduled on the same basis as had been agreed for 1966/67. In 1970, Indonesia reached a final agreement with the Paris Club which resulted in a rescheduling of all outstanding Western claims (including previously rescheduled claims) at very concessional terms (30 year final maturity and <u>no</u> interest charges). The reschedulings were accompanied by increased levels of aid from the Paris club countries and lending on concessional terms.

4. Parallel to reaching the Paris Club agreements, bilateral agreements were reached with the USSR and other East-European countries during the period 1966-1968. Somewhat similar rescheduling arrangements were made with respect to Indonesia's debt to these countries as with respect to the Paris Club countries. In the case of the USSR, for instance, the debt was rescheduled with 2 years

grace and 13 year final maturity, and interest rates between 2 and 3%. In general, reschedulings with Eastern countries during 1966-1969 were done at below originally contracted interest rates.

5. The 1966-1969 rescheduling had a substantial net benefit for Indonesia in terms of near-term cash flow relief. At the time, the present value of the benefits was estimated by the World Bank to be between 22 and 26 percent. The 1970 agreement with the Paris Club had very large benefits for Indonesia due its concessional terms. The grant element was estimated to be 60 percent. The agreement reestablished Indonesia's access to private external finance.

6. The Paris Club terms for Indonesia were considered not to form a precedent for other countries in light of the following circumstances:

1) The debt was contracted under a different political regime.

2) Many of the credits extended had not resulted in any economic benefits for Indonesia since undertakings with very low or negative productivity were financed (military).

3) As a result of the change in economic system, the low level of growth and weak fiscal and monetary policies, central government revenues had fallen to very low levels. The governments' capacity to pay foreign debt was significantly reduced and the largest part of the central government revenues would be used for debt service.[4]

References

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[4]In 1965, the central government revenues were estimated to be 2% of GDP.

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 90/05/03 DUE DATE : 00/00/00
LOG NUMBER : 900504003 FROM : M. Qureshi
SUBJECT : POLAND: Mtg. with Deputy Prime Minister and Minister of Finance, Leszek Balcerowicz, on Sunday, May 6 at 11:30 am.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

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COMMENTS :cc: MH, AK, JV (FF)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: May 3, 1990

TO: Mr. Barber B. Conable, EXC

THROUGH: Mr. Moeen A. Qureshi, Senior Vice President, OPNSV MAQ

FROM: W. A. Wapenhans, Vice President, EMENA WAW

EXTENSION: 32676

SUBJECT: Poland - Your meeting with Deputy Prime Minister and Minister of Finance Leszek Balcerowicz, Sunday, May 6, 1990

Attendance:

1. Messrs Wapenhans, Lari, and Hume will attend from EMENA.

Issues:

2. In greeting the Minister, we suggest you state:

* our appreciation for Poland's recent contribution of 4 million SDRs to support IDA 9 at a time of considerable domestic hardship

* our support for the Government's program (known in Poland as the Balcerowicz Plan) as exemplified by the four loans approved by our Board since February for a total of $548 million and an energy development loan for $250 million negotiated (for which we are awaiting final agreement of government)

* our concern about the pace and actual implementation of the adjustment effort. Specifically, government needs to:

** move rapidly on privatization/enterprise restructuring/demonopolization -this is a major problem on which firm action needs to be rapidly taken: 1) Parliament needs to pass a bill preparing the ground for privatization of enterprises. The Government should then quickly move to implement the law, 2) Government should visibly take action against at least some enterprises delinquent on taxes and required dividend payments, 3) the newly appointed head of the anti-monopoly agency should rapidly develop a vigorous program, 4) a vigorous program should be mounted to promote small and medium enterprises.

** agree on a plan to raise coal prices to border prices during the next 2 or 3 years to complement the recent agreement to fully adjust gas prices during the next 2 years

** agree on a plan to reduce transportation subsidies complementary to the steps to be taken under the recently approved transportation project

** make operational and adequately fund a social safety net, especially unemployment insurance

* our concern about aid coordination, regarding both financial and technical assistance; we understand that a unit is to be set up under Mr. Balcerowicz as Deputy Prime Minister, but it urgently needs to be made operational and efficient

* our appreciation that the joint IBRD/Poland task forces on housing and agriculture are beginning their work in a satisfactory manner

* our satisfaction that the Resident Mission in Warsaw, led by Mr. Ian Hume, will be fully operational on or ahead of schedule

3. The Minister is likely to raise the following issues:

* an increase in the size of the SAL from $300 million to $500 million

Our response is that the SAL $300 million commitment (and $150 million disbursement during 1990) has been included in the balance of payments financing plan drawn up at the beginning of the year, and that the stronger balance of payments position after the first quarter certainly does not justify an increase. For 1991, should the need arise, other lending vehicles such as the proposed financial institutions development loan could have components to disburse against imports.

* IBRD support for a Brady Plan program

Our response is that we would approve set-asides which on the basis of a three year $2.66 billion lending program would be $231 million and "additional funds" (within the total of $2.66 billion) of $347 million; we are also prepared to continue our technical support to the Ministry of Finance

* IBRD support for permanent Paris Club debt reduction

Our response should be that the need for permanent bilateral debt reduction is evident, that we have shared technical analyses demonstrating this with the Ministry of Finance, that we would have no objection were the Poles to share this with the bilaterals, and that we have made and would make the case for permanent debt reduction through other channels.

Background

4. The Balcerowicz Plan is proceeding well in terms of its financial targets. Poland met or exceeded all of its first quarter targets under the IMF program.

* Almost all prices have been liberalized. Inflation is being successfully attacked. The decrease to 6% inflation during March is dramatic against rates of almost 80% in January and 24% in February. But one cannot yet be sure that inflation is under control (for this, it should drop to and remain under 2% per month).

* The budget showed a small surplus during the first quarter, exceeding the target for deficit reduction.

* The balance of payments position thus far this year is very strong, partly because of a large increase in exports prompted by the devaluation, and partly because imports are lagging. The latter relates not only to the devaluation but also to the slow pace of economic activity.

5. Performance in the real sectors is, however, lagging:

* GDP may well decrease this year by 10-15%,

* unemployment could reach 1.5 million or more by the end of the year (about 10% of the labor force).

6. The turnaround in production will depend on effective restructuring of existing enterprises and improved management in the public sector which because of its size will be important for years despite the recognized need for rapid privatization, freeing resources from unproductive uses (through bankruptcies and layoffs of workers), and efficient new initiatives in the private sector.

7. While the balance of payments position is stronger than previously envisaged, the obligations regarding external debt service remain enormous and the reserve position is weak. More adequate foreign exchange reserves are required to continue to implement the stabilization program effectively given the many uncertainties. The expected near term dissolution of the CMEA trade regime in Eastern Europe could cost Poland about $ 1 billion in 1991, since implementing a new trade system based on world market prices will lower the inflated prices now paid for a large proportion of Poland's CMEA exports, while the price adjustment will have a smaller impact on Poland's CMEA imports.[1] The medium-term benefits of a conversion to market prices will be substantial since Polish industry would become more efficient, but a reserve build-up is essential to help meet the short-term costs.

8. The debt situation with the commercial banks is problematic. No debt service on MLT has been paid since September, 1989 and arrears are accumulating. During several recent meetings, the banks have asked for a short term agreement (Poland to pay 15% of interest owed) before moving to discussion of a medium-term agreement, while the Government has stated its intention to reach an agreement as soon as possible to cover the medium term, without making any interest payments (except token amounts on short-term debt). In addition, the recent Paris Club agreement requires equal treatment of other creditors so that Poland would be in violation of the agreement were it to service commercial bank debt during 1990 and the first quarter of 1991.

9. In any case, commercial bank debt reduction will not be enough since this comprises only 22% of total debt. The Paris Club granted Poland 100% debt rescheduling on generous terms for 1990 and the first quarter of 1991. This gives Poland important short-term support, but a longer term solution is needed. Some

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[1] A large proportion of Poland's CMEA imports are raw materials and fuels which are already traded at (approximately) world market prices, while a large proportion of exports are manufactured goods now traded at inflated prices.

permanent debt reduction of bilateral debt is needed, and will be discussed at the G-7 meetings. Something like a one-third write-off of debt service (principal and interest) due from 1991-1995 (similar to "Toronto Terms"), or, equivalently, a 60% reduction in interest owed during 1991-1995 would be needed along with a Brady Plan program to allow Poland the resources needed for adjustment and growth.

Cleared with and cc: Mr. Lari (EM4DR)
cc: Messrs. Hume, Nouvel, Thumm, Loos (EM4CO)

MLav/tr

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 27, 1990

TO: Mr. Moeen Qureshi, Senior Vice President, OPNSV

FROM: W. A. Wapenhans, Vice President, EMN

EXTENSION: 32676

SUBJECT: Poland - Debt and Debt Service Negotiations

1. Background. In January, 1990, Poland has embarked on a courageous reform program, and this will be a difficult year. After prices were liberalized, the rate of inflation shot up to 80% in January 1990. But the Government has implemented a tough stabilization program, and inflation was down to 6% in March. However, GDP may well decline by 10% and unemployment will almost certainly increase to well over 1 million. The sharp devaluation of the zloty in combination with a radical liberalization of the trade regime has given exports an important boost, while imports have decreased; we now expect a trade surplus of $1 billion for 1990, but a current account deficit of $1.2 billion even after the generous Paris Club rescheduling of all principle and interest owed during 1990 (and the first quarter of 1991).

2. Status of External Debt. Poland faces a massive external debt problem caused by excessive borrowing to fund non-viable projects during the 1970s, with a substantial amount of unpaid and capitalized interest adding to the stock of debt during the 1980s. Poland's $40.6 billion external debt amounts to 80% of GDP, and more than 5 times convertible currency export earnings. As Poland implements a courageous reform program, there is a pressing need for resources to sustain the transformation to a market economy and the widespread restructuring of industry so urgently needed, as well as to implement a workable program to reduce debt and achieve creditworthiness in the medium term.

3. Medium-term balance of payments projections show a financing gap of about $20 billion from 1990-1995, after taking into account likely multilateral and bilateral aid.1/ Even after 1995, by which time a substantial amount of debt service would have been rescheduled, a financing gap of about $1 billion per year would remain. Interest due would amount to more than 7% of GDP, or about 30% of the fiscal budget. This would clearly not be a tenable situation.

1/ The projections take into account the impact of a likely reform of the CMEA non-convertible trade regime.

Cleared with & cc: Messrs. Hasan (EMNVP), Thumm (EM4DR)

cc: Messrs. Lari (o/r), Nouvel (o/r), Ms. Loos (EM4)
Shilling, Lamdany (CFS)

MLav/UZachau:mct

4. Status of Negotiations with Commercial Banks. The Government of Poland has not made debt service payments since October 1989, except on its $1 billion trade facilities. Interest arrears for the last quarter of 1989 are $145 million. The Government has recently met repeatedly with the Bank Advisory Committee and its Economic Subcommittee. The banks are looking for a temporary solution for 1990 and are currently asking Poland to pay its 1989 arrears as well as 15% of the interest due in 1990, with the remaining 85% being refinanced and consolidated with the existing trade facilities, which are to be replenished. The Government is prepared to pay 50% of its 1989 arrears and has requested a refinancing of all interest payments through March 1991 (the period of the IMF and Paris Club agreements), reminding them that the February 1990 rescheduling agreement with the Paris Club, which requires no payments in 1990, calls for equal treatment by other creditors. In addition, the Government asked that the banks enter into discussions with Poland concerning long-term debt relief.

5. Bank and IMF Support of Debt Reduction. On request, the Bank has indicated to the Government its support (in principle) of a debt and debt service reduction package with the commercial banks. The current IBRD lending program calls for commitments of $2.66 billion for FY90 to FY92. Assuming that this includes possible "additional" funds for interest support, the Bank's guidelines would allow for set-asides of up to $231 million and additional funds up to $347 million. Support from the IMF could amount to up to $330 million in set-asides and $350 million additional funds. Thus, total IFI support could reach about one and a quarter billion dollars.

6. Outline of a Possible Package. The Bank has provided technical assistance to Poland in designing and discussing with the Government the features of illustrative debt and debt service reduction packages. A possible deal could consist of a partial buyback of about one-third of the debt and the exchange of the remaining debt at par into an interest reduction bond with a very low initial rate, which slowly increases up to market rates. The additional funds from the Bank and IMF would be used to collateralize interest payments and could be put into an escrow account, whose balance through the accumulation of interest grows to an amount sufficient to repay the principal of the bond at maturity. In this way, all of Poland's debt with the banks would be on commercial terms in 10 years from now. The implementation of such a package would imply an efficient use of Bank and IMF resources, and would not require a relaxation of the fungibility constraints in the current guidelines of the IFI's.

7. Adequacy of Financing Program and Role of Debt Reduction. About two-thirds of Poland's external debt and an even higher percentage of its debt service obligations over the next 5 years is to the Paris Club. Only slightly above 20% of convertible currency debt is owed to the commercial banks. For this reason, Poland's financing gap cannot be closed by a reduction of commercial debt and debt service alone. However, in the presence of concerted debt and debt service reduction from Poland's bilateral creditors (to ensure fair burden sharing, both the Paris Club and the CMEA), a commercial debt reduction package could close the remaining financing gap. In the long-term, it could also help Poland regain access to international capital markets.

8. Downside Risks and Contingency Financing. The management of the economic reform program as well as the CMEA trade conversion and the likely negative impact of the unification of Germany on Poland's exports pose substantial downside risks. Since it appears unlikely that banks would agree to contingency financing, it will

be particularly important to link Bank support for debt reduction to sustained adjustment supported by the Bank and the IMF as well as to an appropriate build-up of reserves.

9. <u>Phasing and Frontloading</u>. A commercial debt reduction deal is unlikely to be agreed upon before the first half of 1991. But for both 1991 and 1992, Poland's balance of payments shows significant gaps, even with bilateral debt and debt service relief. For this reason, a viable financing program will likely require some frontloading. The Government has already asked for a set-aside from the SAL, and is likely to request similar set-asides from upcoming loans in anticipation of a future agreement with the banks. Therefore, the degree of frontloading necessary at the time should not pose serious problems, depending of course on the exact timing of the debt reduction agreement and the track record that Poland will have established by then.

10. <u>Inflexibility of Resulting Debt Structure</u>. Since Poland will likely receive substantial support for debt reduction from the IFI's and its commercial debt accounts for only about 22% of its total convertible currency debt, a deal will likely be relatively comprehensive, but at the same time make a large portion, if not all, of the remaining commercial debt less flexible (e.g. by converting it into collateralized bonds). This problem will be more severe if commercial debt reduction will be negotiated before Poland obtains debt relief from the bilaterals, since in this case banks will be faced with the possibility of remaining financing gaps. In particular, they will want to protect themselves against the possible default even on their reduced claims by making their remaining claims as senior as possible. In this situation, one should resist potential pressures to convert debt into bearer bonds rather than registered bonds or to imply some kind of senior status for the new reduced claims.

Additional Info: mtg. on
May 6 @ 11:30a

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 90/05/04 DUE DATE : 00/00/00
LOG NUMBER : 900504012 FROM : Mr. Ilczuk
SUBJECT : Poland's Economic Transformation: A Progress Report

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:
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COMMENTS :
cc: Mrs. Haug, Anupam

May 2, 1990

Poland's Economic Transformation: A Progress Report

On January 1, 1990, the Polish Government began the most radical economic reform ever attempted in modern economic history: transforming a centrally-planned economy into a Western-style competitive market economy based on private ownership. At the same time, the Government executed a shock stabilization program to break the hyperinflation that ran at an annual rate of 2000% in the last half of 1989.

The early results are encouraging. The currency has been stabilized and made convertible for all trade transactions, and inflation has been drastically reduced (though the Government is aiming to reduce further the present rate of about 5 percent per month). The fundamental switch to a normal market economy has begun, and the economic environment in which private and state enterprises operate has been radically transformed. For the first time, enterprises can not automatically sell all they produce and the vast majority of shortages have been eliminated. In addition, stabilization and the removal of trade barriers have brought competitive pressures to Poland from the world economy, and the prospects for Poland's export sector are good.

At the same time, the economy is in a recession, as real wages and production have fallen. The resolve of the population to see its way through the transformation process remains strong, as there has been little strike activity and opinion survey results are still positive. The depth and duration of the recession are unpredictable, however, and in all likelihood continuing low output and further declines in employment will tax the patience of the Polish people.

The challenge facing the Government is to consolidate the fragile stability already achieved, reduce the inflation rate to the levels prevailing in the market economies of Western Europe, and hasten the process of structural adjustment needed if sustainable growth is to be achieved. Important tasks, such as privatization, demonopolization, banking reform, tax reform, the adoption of a modern accounting standard, the reform of legal codes, and environmental cleanup, for the most part lie ahead. As the Government has explained to the population, efforts to artificially stimulater the economy at this point would endanger the stabilization process and, thus, undermine the achievement of these goals.

This paper briefly notes the situation facing the new Government last September, describes the key elements of Poland's economic program, summarizes the results to date, and outlines the remaining agenda. In this last section, there is an indication of the vital role that external financial assistance from the West must still play in ensuring the success of economic transformation in Poland.

1. The situation in September 1989

When the present Government took power in September 1989, the Polish economy suffered from the drawbacks of an Eastern European-type socialist economy plus those of a market economy out of macroeconomic control. The economic system was based neither on the plan nor the market. About half of prices were free, but many scarce resources remained under administrative control. The price system was in disarray, with many key relative prices, such as the price of energy, wildly out of line. International trade was subject to pervasive restrictions while foreign exchange was rationed, isolating the economy almost completely from foreign competition. Most restrictions on the private sector had been lifted in 1989, but monopolistic public enterprises, which had dominated the economy for decades, were still accustomed to cheap bank credits, pervasive excess demand for their outputs, and lack of competition.

The progress that had been made by the previous government in moving towards a market economy did not prevent a rapid deterioration of the economic situation. The strategy of partial transformation had led to severe macroeconomic disequilibrium by September. Owing to the absence of adequate controls over monetary, fiscal or wage policy, a sweeping food price liberalization in August led rapidly to hyperinflation. The budget and the banking system had developed large imbalances that had been financed largely by the printing of money. As inflation accelerated, tax revenues, public utility charges, and energy prices fell behind, exacerbating the budget problem.

2. Strategy of the Government

In the face of this intolerable situation, the new government decided not to try to live with inflation, believing that such a course would preclude all efforts at structural adjustment. Instead, the government chose to stop the inflation with a comprehensive stabilization program. The program was designed to combine tight macroeconomic control with liberalization of prices and foreign trade. Budget balance and positive real interest rates were to set the conditions for price stability, while price and trade liberalization were to allow markets to function normally and provide competition to domestic monopolists. A stable currency and wage restraint were to provide anchors for the price level, speeding the elimination of inflation and minimizing unemployment during the transition.

At the same time, the Government undertook a process of deep systemic changes, moving as rapidly as feasible to a Western-type market economy based on proven institutions and practices. Price and trade liberalization provide the foundation for such a transformation, but the institutional changes required are enormous. They include demonopolization, full currency convertibility, banking and financial reform, and, most importantly, sweeping privatization of industry and trade.

3. The implementation of the program: stabilization

Elimination of price controls. The Government has eliminated most price controls and now more than 90% of prices in the Polish economy are freely determined in the marketplace, compared to about 50% last year. As in some Western economies, there are exceptions, such as various utility rates and public transportation fares.

A balanced budget. After a deficit of 9% of GDP in 16989, a deficit of 1% is forecast for 1990. The budget has been running a surplus so far this year, due to drastic cuts in subsidies, reduction in government investments, decrease in foreign debt service, and increases in revenues.

Last year and on January 1, subsidies were eliminated on meat, bread, and most other food-stuffs, for example. Remaining large subsidies are in coal and rent. Subsidies were drastically reduced on most other products. Coal prices increased by 600% to consumers and 400% to producers, electricity by 300%, and transportation by 200%.

Trade liberalization. Virtually all quantitative and licensing restrictions on imports have been eliminated, and the average import tariff is about 10%. While there remain expert tariffs and quotas on a few goods, the great majority of such export restraints have also been eliminated.

Establishment of a convertible currency. There are no restrictions on the availability of foreign exchange at the official rate for all trade transactions. Poland is the first Eastern European currency to establish a convertible currency in this sense. To permit convertibility and free trade required a devaluation of the zloty by 58% on January 1.

Tight monetary policy. Positive real interest rates and a disciplined monetary policy have helped bring about the rapid elmimination of inflation and the stabilization of the currency. The basic lending rate of the National Bank of Poland has been strongly positive in real terms since February, the first time in postwar Polish history.

Wage restraint. A tax-based wage policy was designed to help break the inflationary spiral. To achieve restraint in an economy still dominated by state enterprises, a limit was placed on permissible increases in wages and enforced by subjecting excessive increases to high taxes. In the event, wage pressure has subsided as unemployment has increased.

4. Results of the stabilization program.

Inflation. Inflation has been brought down sharply. Prices jumped in the opening weeks of the program, reflecting the needed correction of relative prices. January prices were on average 78% higher than in December, and food prices, for example, rose by 80% in the first three weeks of January. By the third week of January, however, the tough new measures on wages, interest rates, and fiscal policy had brought inflation down, and prices grew an average of four to five percent per month in February and March. This is still unacceptably high, and over the next few months the policies in place should bring inflation down to rates similar to those of Poland's Western trading partners.

Shortages. Shortages have been effectively eliminated. The shops are well stocked with food, durable goods and products of all kinds. To take one example, the doubling of gas prices has eliminated the six-hour lines for gasoline that were common in December. Thriving private markets provide an unprecedented array of domestic and imported goods.

Foreign Trade. Exports to the West have already started to increase, due to the devaluation of the zloty and the elimination of previously endemic excessive domestic demand. In the first quarter of the year exports were 7% higher than the same period of the previous year. This trend appears to be strengthening, as March exports were 19% above the previous year. Strong sectors include electrical machinery and food. Meanwhile, the high value of the dollar and the fall in production and wages have reduced imports sharply. The trade balance has therefore been strongly positive in the first three months.

Employment. The Polish economy is in a recession. The total number of registered unemployed at the end of March was about 3% of the nonagricultural labor force, after being essentially non-existent until this year. This increase must be kept in the proper perspective. Less than half of this number represent individuals who lost their jobs on account of business conditions. The remainder include new entrants to the labor force (many of whom were probably attracted by the benefits now available for the first time) and voluntary job leavers.

Whatever number is used, unemployment in Poland remains low when compared with Western countries. The Polish people understand that the deep and fundamental transformation that is being attempted will require a massive resource reallocation and can be expected to lead to a much greater level of unemployment. The Government remains committed to economic transformation, because it is the only route that holds out the promise of sustained economic growth. Accordingly, the Government has designed and funded a program to provide money and job retraining to the unemployed.

5. The implementation of the program: Institutional changes

Price liberalization. As mentioned above, prices are now largely market determined. The remaining state-controlled prices, especially energy and transportation, have been increased dramatically.

Free trade. Poland intends to follow a pattern of export-led growth. Poland's complex system of multiple exchange rates, rationed foreign exchange, pervasive licensing and state monopolies in foreign trade have all been eliminated and tariff rates slashed. The structure of international prices has thus also been largely 'imported', bringing efficiency and competition.

Privatization. The process of transforming the Polish economy into one dominated by private ownership has begun. Privatization of shops and small enterprises has already begun, and preparations for the difficult task of large-scale privatizations are under way.

Banking Reform. The banking system has been separated from the budget, as independence of the National Bank of Poland has been legislated. The development of a normal commercial banking sector has processed steadily since the creation last February of a two-tiered banking sector, with a central bank and commercial banks. Positive real interest rates have combined with legal bank independence to break the historic subservient role that banks have played with regard to the public sector.

The development of financial markets and the growth of the private sector will be made possible by the reform of the banking system. Private banks are now encouraged in Poland. Sixteen applications for private banks were approved last year, and many more are now in the process of being approved, including joint ventures and entirely foreign-owned banks.

Demonopolization. Measures have been taken to break up the monopolies that characterized the previous system. National monopolies of meat-processing and trade have already been eliminated. A new anti-monopoly law has been passed and enforcement is just beginning. A critical step towards encouraging competition, and one that has already exerted tremendous pressure on firms, was the opening-up of the economy to foreign trade. Much remains to be done, however, to convert Poland's highly monopolized economic structure into a more competitive one.

Other legal reforms. New laws on foreign exchange, direct foreign investment, and foreign trade have been adopted. The draft law on privatization of public enterprises has been completed and will the complement the changes made in 1989 that eliminated legal discrimination against the private sector.

6. Results of the institutional reforms.

Product markets. The price liberalization has combined with the opening to foreign trade to bring relative prices have been brought much more in line with true economic scarcity, shortages and rationing have been eliminated. The market has taken on its normal role of allocating scarce goods, replacing the complicated combination of market and administrative allocation that preceded it.

Labor markets. The first appearance of unemployment in decades has signaled the beginnings of a labor market. The effects on efficient allocation of labor are only just being felt, although attitudes towards work seem to have already improved. Rates of sick leave, for example, are drastically lower than before, reflecting a new desire to be useful at the workplace.

Financial markets. Financial liberalization and banking reform have led to the beginnings of financial markets. An interbank lending market has developed, while bills-of-exchange have begun to replace inter-enterprise arrears, leading to a market for commercial paper. Government and some commercial bonds have been sold to the public in limited quantities and a secondary market is forming.

State Enterprises. Enterprises now face a new, harsh economic environment. For the first time, credit has become expensive and enterprises race the "barrier of demand": customers' desire to purchase their production is limited, and enterprises must compete on price and quality and look for export outlets.

Domestic trade. The regional state monopolies that have dominated internal trade are under pressure from positive real interest rates and private market competition. A thriving private market has developed, especially for food and imported goods.

7. Remaining agenda

Privatization of state enterprises. The Government plans to privatize thousands of state-owned enterprises, representing the major part of Polish industrial production, over the next several years. A draft law has been submitted to the Parliament, and work is proceeding as fast as possible on the preparation of major firms for privatization. Many small enterprises and retail trade outlets are already being sold or leased to the public.

Restructuring of state enterprises. Few enterprises have the managerial skills to make the necessary adjustments to the new conditions quickly and to prepare themselves for privatization. Massive management assistance is needed to assist these enterprises in the adjustment process. Without such assistance, many enterprises which could be viable may be forced into bankruptcy because of the inexperience of their management in coping with the competition of a market economy. The extensive unemployment and further loss of output which would result could undermine the entire reform program.

It is urgent that Western managerial expertise be brought to Poland to assist Polish enterprises. Many can expect to go bankrupt over the next several months and years. Efforts are under way to provide the management and training resources that will allow enterprises to respond to the new environment, while the government is developing the institutions that will facilitate the restructuring and privatization of struggling enterprises.

Development of financial markets. Complementing privatization will be the growth of financial markets. Most important are the progressive establishment of a securities market and further development of the banking sector. Technical assistance will be vital in allowing these sectors to contribute as they should to the restructuring of the economy.

Demonopolization. Despite the progress so far, much remains to be done to demonopolize Polish industry. The new anti-monopoly law must be vigorously enforced.

Tax Reform. The current schedule for reform envisages implementing sweeping changes in the tax code in 1991 and 1992, bringing it into line with those typical in Western Europe. Planning are a VAT, a comprehensive personal income tax, and an enterprise income tax. These are replacing the complicated, onerous and inefficient tax laws left over from the previous system. A reform of local taxation is also under way.

Budgetary reform. Further reductions in subsidies are being planned for 1991 and 1992, by which time virturally all major budget subsidies will be eliminated.

8. The reduction of foreign indebtedness

Debt service payments due in 1990 to official creditors have been generously rescheduled by the Paris Club. Discussions are underway with commercial bank creditors as well. But, in our view, cash flow relief should only be the prelude to a permanent and lasting resolution of the debt problem. Long-term macroeconomic stability and the participation of foreign investors in the economy require confidence in the viability of the balance of payments over the medium term. Such confidence will only be possible following a permanent reduction of the burden of the inherited foreign debt, both of commercial and official creditors.

The government of Poland considers that to restore the viability of its balance of payments will require a reduction in the burden of its external debt of about 80%. This judgment is based on several analyses which all point to the same conclusion. Most importantly, a series of balance of payments projections extending over the medium term indicate that lesser amounts of debt reduction would result in financial gaps that would need to be covered by rescheduling and concerted lending over the entire period. Financial markets reflect this fact, as the current price. of Polish obligations to commercial creditors in international secondary markets is about 15 cents per dollar.

The government of Poland wishes to negotiate debt reduction with all its major creditor groups, on a comprehensive basis and with all due attention to the comparability of treatment accorded by creditor groups. From the official creditors in the West, which hold the largest share of Poland's external obligations, the government of Poland requests a permanent cut in annual interest obligations owed in foreign currencies to about 2 percent of the present face value of these obligations. This could be achieved through either reductions in principal amounts or interest rates as might be desired by creditor governments. From the commercial bank creditors, the Government of Poland requests a reduction of similar present value. The mechanisms to effect such a reduction would be arranged over the coming months.

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CONFIDENTIAL 2) BBC

3) Co. File (MF)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DECLASSIFIED
AUG 2 4 2015
WBG ARCHIVES

DATE: May 6, 1990

TO: Memorandum for the Record

FROM: Eugenio F. Lari, Director EM4

EXTENSION: 32552

SUBJECT: POLAND: Mr. Conable's Meeting with Minister Balcerowicz

1. On May 6, Mr. Balcerowicz met with Mr. Conable for over one hour. He was accompanied by Mr. Sawicki (Vice Minister of Finance), Mr. Boniyuk (Deputy Director, Foreign Department, Ministry of Finance), Mr. Krowacki (Counsellor, Financial Affairs at the Embassy). Messrs. Qureshi, Wapenhans, Fischer, Hume and I accompanied Mr. Conable. Messrs. Caranza (ED) and Ilczuk (Advisor), were also present.

2. After expressing appreciation for the assistance received so far by the Bank and the close dialogue with the staff, Mr. Balcerowicz gave a broad updating of the situation in Poland. The stabilization program is on track, although inflation is still at 6% per month due to utility tariff adjustments. The price structure is being changed: coal prices are up, for industry, transport and for retailers. Telecommunication tariffs are up too. A few shortages are still there (e.g., fuels, due to inefficiency of the state distribution enterprises), but this is exceptional.

3. Better than expected BOP results provide the Government with an extra cushion. Turnover taxes and tariffs (which in effect add 20-30% to the exchange rate) are to be reviewed and lowered (the tariffs after considering GATT regulations). Revenue 1989 arrears have benefitted the fiscal balance in 1990 so far, in addition to increased fiscal discipline. First quarter's industrial output sales, however, are down 25%. It is not as bad in agriculture. There is a 3% unemployment (half only genuine). Enterprises start changing their product mix and marketing strategies. CB rediscount rate has been lowered 5.5% per month (including fees, interest rates actually charged to banks are higher).

EFLari:nsp

cc: Messrs/Mesdames. Conable; Qureshi (OPNSV); Wapenhans, Hasan (EMNVP); Thumm, Zaidan (EM4DR); Nouvel, Loos, Lav, Ramasubbu, Sood, Apitz (EM4)

4. CMEA changes are still in flux. A decision will be taken this year on a new mechanism and a transition period. Two models are under consideration: free dollar trade (but it is feared that it would have a very negative impact on Polish engineering exports to USSR) or the Finnish trade system (for a certain time, at least). A "red dollar" at 7,500 applies to 15% of trade with USSR on an experimental basis, now.

5. As far as enterprise restructuring is concerned, Mr. Balcerowicz said that it would be overseen by two institutions: an Agency for Restructuring under the Ministry of Industry, and a Bank for Restructuring. There were, however, serious problems in finding the right people; he was ready to look outside Poland.

6. As far as the safety net was concerned, the Government was introducing a program of employment generation activities, credits, training--with unemployment compensation as last resort (and at a rather low level).

7. Mr. Balcerowicz also stressed the Government's plans for SMEs promotion, and in general confirmed his intention to accelerate the process of privatization of the economy.

8. Mr. Conable indicated that the Bank program was of about $2.6 billion for three years, and noted that it was moving faster than originally foreseen. He then asked about the external debt scenario as seen by the Government.

9. Mr. Sawicki replied indicating the Government's intention to benefit from the Brady Plan with World Bank assistance. Regarding the issue of set aside and additional money, he asked what was the World Bank's position.

10. Mr. Conable answered that, in principle, the Bank was ready to assist, but there was a timing problem. He thought that in the event about $500 million from the Bank in set asides and additional money was likely, but he needed to see the overall picture, especially progress with the Paris Club.

11. Mr. Balcerowicz said that to some extent this progress was linked to the SAL size.

12. Mr. Qureshi stressed the need for reasonable clarity--at least in principle--on the side of the Paris Club major creditors on a long-term arrangement (at least on its main lines) before getting an arrangement with the London Club and having Bank/IMF supporting such an arrangement. He also noted that the main Bank/IMF shareholders are also in the Paris Club. The Bank then would be flexible, irrespective of SAL size. For example, we could have a separate operation. He told Mr. Balcerowicz that he could already tell the London Club that "the Bank would be prepared to support an acceptable program arranged with the commercial banks," with both set asides and incremental financing.

13. Responding to a query, Mr. Sawicki indicated that the Paris Club working group was to accelerate its activities as soon as the IMF review of the Polish program is completed (May 14).

14. Mr. Balcerowicz then asked for further clarification on the Bank's position.

15. Mr. Qureshi stated that in the SAL loan documents we could say that a certain amount could be earmarked for set aside--until a certain date, after which it could be used--if not needed for set aside--for general import needs, under the general SAL rules. Bank (and IMF) could be expected to be assisting Poland for many years, he added, but now Poland should maximize assistance from Governments. A year or two from now, the Bank may need to do more in assistance to Poland and would be ready to do it in order to deepen the reform.

16. He went on to say that the commercial banks should not be treated better than the Paris Club, and both Clubs should understand this.

17. While tacitly supporting an agreement now, as soon as an agreement with commercial banks was in sight, the Bank would write to the commercial banks (two-three months from now ?) indicating explicit support. The Bank could be present at negotiations, if requested, but without actively participating in them.

18. Regarding the official credits, press now with the key Ministers, he suggested, to obtain a long-term viable framework and so dispel uncertainty which stops, among others, the Bank from generating major loans (SAL), as well as regularizing relations with the private sector (commercial bank credits, trade facilities, foreign investments).

19. On industrial restructuring, Mr. Balcerowicz indicated that regions had been selected for priority action; a data bank had been set up to screen enterprises on the basis of economic and environmental criteria. An inter-ministerial committee had approved a preliminary list of firms to be subject to closure (including some mines). (Removal of restrictions this year and next should result in higher coal prices.)

20. He went on to say that external Aid (all inclusive) coordination would be much improved under a new commission, chaired by him, with a stronger secretariat. The Warsaw Bank Office could help in strengthening the mechanism. This Commission intended to be pro-active and would use institutions already in place (e.g., Olechowski's).

21. Answering Mr. Conable's question, Mr. Balcerowicz said that political support for the Government was still strong (though somewhat decreasing).

22. After Mr. Wapenhans encouraged the Government to implement Bank loans effectively and quickly, the meeting ended on a strong note of Bank support for the Polish reform.

23. A briefer follow-up meeting took place in Mr. Caranza's office, which I also attended at his request.

24. At this second meeting, Mr. Balcerowicz clarified that he is now very much in charge of privatization (directly and through Vice Minister Lys), although a new separate entity is about to be created; he also is very much involved in enterprise restructuring, although he is not formally in charge of it. Bank staff should continue to discuss with him/his Ministry these matters; also, any problems with sectoral ministries, should be referred to him/his ministry.

25. Regarding privatization, various schemes are still being debated. He favors use of vouchers: but how many ? To whom should they be distributed ?.... Although firmly intentioned to accelerate the process, the Government is still unclear and undecided on how to do it.

Poland ~~*AC~~

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 90/03/29 DUE DATE : 00/00/00
LOG NUMBER : 900329001 FROM : E. Stern
SUBJECT : POLAND: Request for Bank Support to a Debt-Reduction Program for Commercial Debt.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

	APPROVED
	PLEASE HANDLE
	FOR YOUR INFORMATION
✓	FOR YOUR REVIEW ~~AND RECOMMENDATION~~
	FOR THE FILES
* ✓	PLEASE DISCUSS WITH BBC
	PLEASE PREPARE RESPONSE FOR ______ SIGNATURE
	AS WE DISCUSSED
	RETURN TO (MH o/r)

COMMENTS :Note: Pls. see last para.

3/29/90

MARIANNE:

I talked to Willi Wapenhans this morning. They are not planning to send a letter any more because the discussions with commercial creditors have already started. Instead, Eugenio Lari has been in telephonic contact to convey the gist of the Bank's position.

I told Mr. Wapenhans that Mr. Conable did not feel that the third condition in para. 4 was enough. Mr. Conable wants a resolution of the issue, as he had discussed with Mr. Qureshi. Mr. Wapenhans said that they agreed with the position, which was also what they were taking.

Anupam

March 28, 1990

Mr. Conable

Barber -

Poland - Request for Bank Support to a Debt-Reduction Program for Commercial Debt

Marianne had spoken to me about this, as has Mr. Wapenhans.

While I agree that any debt reduction must be in the framework of a medium-term plan, and that we should support such an effort, I am less sure that stating our support in a formal letter is a good idea at this stage. As Mr. Wapenhans notes, this might have important ramifications for our exposure in Poland. In addition, it will, inevitably, create precedents for other countries in Eastern Europe. To constrain our support only by referring to the size of the lending program is not very satisfactory. For instance, I would not consider it appropriate to proceed with support for debt reduction while Poland has only a 1-year moratorium from the Paris Club.

I believe that it would be helpful to discuss this further with you, and all or some, members of the PC before we send a letter. It would also be useful, if the text of the proposed letter could be reviewed.

Ernie

Ernest Stern

cc: PA ✓

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: March 20, 1990 CONFIDENTIAL

TO: Mr. Moeen Qureshi, Senior Vice President, OPNSV

FROM: W. A. Wapenhans, Vice President, EMENA

EXTENSION: 32676

SUBJECT: Poland - Request for Bank Support to a Debt-Reduction Program for Commercial Debt

1. During a meeting on March 14, Minister Sawicki (Vice Minister of Finance responsible for external debt), requested Bank support for a program of commercial debt reduction, along the lines of the Brady Plan. Minister Sawicki stated that the GOP wished to pursue such a program and needed the Bank's assistance and support, but that they had only begun to think in concrete terms about how to move on such a program.

2. As you know, the Paris Club recently granted favorable rescheduling to Polish public debt, which is about two-thirds of Poland's total external debt. The Poles were to meet with the London Club last week, but the meeting has been postponed towards the end of March. Minister Sawicki hoped that he could get from the Bank a response in principle before that meeting. Commercial debt to the London Club is about 25 percent of Poland's external debt, i.e., about $9 billion. Initial exploratory discussions with the Poles on debt strategy issues took place earlier this month during a visit of CFSFA staff, at the time of the SAL appraisal mission. Since about the middle of last year, Poland had stopped servicing its obligations both vis-a-vis the Paris and the London Clubs.

3. In my response, I stressed that for the Bank to consider supporting Poland's request, it would be necessary to relate a possible debt-reduction program to the overall development of a debt strategy, which is both realistic and treats as equitably as possible all external creditors, i.e., the Paris and London Clubs, as well as other creditors. I also stressed that any debt reduction had to be seen as an element of the development of an appropriate medium-term framework which would show a reasonable path towards Poland regaining creditworthiness, an aspect that was also guiding the development of our lending operations. After developing these considerations, I told Minister Sawicki that the Bank would hope to be able to send to the Minister of Finance a letter before the next meeting of the London Club, which would indicate our agreement in principle to consider supporting a commercial debt reduction program, provided certain conditions could be met.

cc: Messrs/Mme. Lari (o/r), Thumm (EM4DR), Sood (EM4IE), Ms. Loos, Lav (EM4CO); Bock, Shilling, Lamdany, Zachau (CFS)

MLav/PNouvel:mh

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4. As we discussed, I believe those conditions should be the following. First, the Poles need to develop a coherent and reasonable medium-term framework which shows return to creditworthiness. Second, a detailed debt strategy has to be incorporated in this medium-term framework. Of course, several alternatives will have to be considered, but the specifics of each should be clearly delineated. Third, the Poles should continue discussing with the Paris Club and their public creditors how they can contribute to this debt strategy through reducing the debt burden, particularly as regards interest levels and payments. (We will have to find a way to get a confirmation that the Soviet Union will participate in a debt-unburdening strategy.) Fourth, at this stage we should not consider any financial support from the Bank outside the agreed $2.5 billion lending program. Evidently, participating in a debt-reduction program would have implications on Bank exposure. This will be addressed in the strategy paper that is being planned in the next few months. And, finally, we would want to remain in close touch with the Poles as they develop their negotiating position for a comprehensive program. In developing such a program, we would, of course, work closely with our colleagues in the IMF.

5. Do you agree with the proposed approach?

Not enough. There must be reduction

Record Removal Notice

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File Title	Barcode No.
Poland - Country Files - Correspondence - Volume 1	1779845

Document Date	Document Type
January 11, 1990	Memorandum

Correspondents / Participants

From: Bilsel Alisbah, Vice President, PAAVP

To: Mario Draghi, EDS21

Subject / Title

Polish Nationals in IRBD

Exception(s)

Additional Comments

Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Ann May	September 28, 2015

Poland - C.F.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 31, 1990

TO: Mr. W.A. Wapenhans, EMNVP

FROM: Eugenio F. Lari, Director, EM4

EXTENSION: 32552

SUBJECT: POLAND - Proposed $300 Million Structural Adjustment Loan Initiating Memorandum

1. I attach for review by the Operations Committee on February 9, 1990 the draft Initiating Memorandum for the proposed SAL to Poland.

2. The draft IM tries to strike a balance between the traditional type of SAL conditionality and the need for more than usual flexibility in light of the great uncertainties involved in the Polish reform program, which is venturing into the largely uncharted waters of transition from a centrally planned to a market economy. Although an attempt was made to provide tentative medium-term projections as a basis for the macroeconomic framework and financing plan, these projections are likely to undergo major changes as a clearer picture of the macro-micro interface (additional financing requirements of the enterprise and financial sector, social safety net, and government investment within the overall resource constraints) and of external financing/debt relief evolves. Similarly, the core components of the program are translated into a number of individual reform initiatives, however without great specificity as to the exact nature and timing of the measures (which require additional preparation work).

3. In determining the scope and design of specific policy measures, the transition character of the program as a first step in a multi-year reform effort will have to be taken into account. The final agreement will focus on those measures that are crucial for the ultimate success of the macroeconomic program, including a quick supply response and adequate social provisions. In that sense, some of the financial sector reform actions could be stretched over a slightly longer period of time and the environmental conditions in the context of enterprise restructuring might also be somewhat relaxed, while the legal and regulatory framework for enterprise restructuring and privatization as well as the establishment of an adequate social safety net would have to be as strong as now being proposed.

4. A major source of uncertainty in the program is the external financing, given Poland's urgent need for debt relief beyond traditional rescheduling. Work will be initiated in parallel to the SAL appraisal to explore possible options as a basis for Poland's external financing strategy. This will have to be followed up by the Bank through intensified consultations with the main creditors, in particular the bilaterals and commercial banks. Cofinancing (preferably on

concessional terms) with the Japanese Ex-Im Bank and other bilateral creditors will also be further explored. An external financing strategy should be agreed with the Government before Board presentation of the SAL, while adequate progress in implementing the strategy would be a condition for second tranche release.

5. Given the monumental character of the reform program (stabilization from a hyperinflation situation and systemic transformation), the degree of uncertainty is unusually high in the Polish case. The program to be supported by the Fund's standby arrangement may run into problems which might it make difficult for the Bank to go ahead with the proposed SAL. However, the SAL is being designed in a way that the core program consists of longer-term institutional reforms which would have to take place under all circumstances. In that sense, a revised and less radical Fund program (to "salvage" the SBA if it faces problems) may still provide an adequate basis for a SAL. In the worst case scenario, which could unfold over the next two months, we might consider traditional project or hybrid lending support for the three core components of the program instead of the proposed SAL. Tranching different from the proposed two equal tranches (e.g. backloading or three tranches) is also an option to adapt to the highly uncertain developments.

6. The Polish Government is interested in increasing the loan amount from $300 to $500 million. This increase is not crucial to close the projected financing gap which will have to be financed mainly through debt rescheduling and debt and/or debt-service reduction (or equivalent measures). The increased loan amount would, however, contribute to a rapid increase in Bank exposure through greater front-loading of actual Bank financial assistance. The issue should be discussed in the broader context of the proposed assistance strategy summarized in Section V of the IM which is more geared to project lending for specific high-priority modernization projects.

Attachment

POLAND - Proposed Structural Adjustment Loan

Initiating Memorandum

I. Background

1. On two occasions during the last 15-20 years, Poland attempted to reform its economy. Both attempts failed. The reform effort of the 1970s led to a surge in investment through ill-conceived technological modernization projects which essentially resulted in steeply increased debt without a commensurate increase in the country's debt-servicing capacity and, thus, the financial crisis of 1978-82. The following attempt launched under Martial Law in 1981 went much further by introducing some elements of systemic change, particularly decentralization of economic decision making, while at the same time maintaining a highly interventionist system based on an intricate array of controls and subsidies. The reforms had ground to a halt by 1986, and a second stage of reforms was called for. However, that second stage, while producing a number of important reform initiatives, e.g., in the financial sector, ultimately did not succeed without fundamental political reforms.

2. In 1989, Poland has achieved historic political changes. The parliament elected in June and the coalition government of Prime Minister Mazowiecki constitute new political forces with a strong popular mandate and a demonstrated commitment to economic reform. At the same time, the Government faces extremely serious economic problems and exceedingly high expectations. Time is short. The program launched at the beginning of 1990 requires adequate external financing, and some clear and early signs of success are needed in order to maintain public support.

3. During the course of 1989, the previous government had initiated a process of significant institutional reforms. A new legal framework supporting private sector activities has been established, central allocation of resources reduced, prices in agriculture liberalized, and the banking system reformed. The new laws and regulations, however, have not been fully implemented in many cases, and financial discipline at the enterprise level is still lacking. At the same time, macroeconomic balances have deteriorated badly, partly as a result of the prolonged political negotiations last spring and the absence of an effective government last summer.

4. By implementing a radical and far-reaching program at the beginning of 1990, the new Government has forcefully demonstrated its commitment to rapid economic reforms aiming at the establishment of a "social market economy". The Government is pursuing a two-pronged strategy: stabilization and structural adjustment via systemic transformation in pursuit of restored growth with equity and improved creditworthiness. To succeed, the systemic transformation requires a stable macroeconomic framework and reduced inflation. At the same time, stabilization efforts will succeed only if financial discipline can be imposed on enterprises. This suggests that needed changes should be introduced rapidly and simultaneously at both the macro and the microeconomic level. However, given the numerous constraints in the Polish economy, the supply response may lag behind as economic agents are conditioned by 40 years of existence in a command economy.

5. Lack of creditworthiness is another complicating factor. Poland's debt burden is among the highest in the world, with DOD equivalent to about 60 percent of GDP at the official exchange rate (which was greatly overvalued until recently), and scheduled debt service payments, even after successive reschedulings, equivalent to about 90 percent of foreign exchange earnings (including remittances). Poland has built up arrears with its Paris and London Club creditors. While it serviced its commercial bank debt until the spring of 1989 under a London Club rescheduling, it deferred principal payments in April 1989 and interest payments beginning in September. The Polish reform efforts need generous external financial support to allow the necessary time to yield the expected results. Financial support is needed both to make the stabilization credible and to permit expansion of imports to stimulate competition and to provide breathing space until the domestic supply response materializes. The 1990-92 external financing requirements are estimated at about $20 billion (including a cumulative increase in reserves of some $2.3 billion). The bulk of this requirement would have to be financed through rescheduling and concessionary debt relief as a major increase in the already heavy debt burden would be unsustainable.

6. The Government's monumental task of stabilization and systemic transformation faces high risks in light of high indebtedness, political uncertainties, and excessive expectations of the populace. So does Bank lending. At the same time, the potential outcome seems well worth taking the risks. Moreover, proposed Bank lending will be part of a concerted effort involving strong commitment to reform on the part of the new Polish Government as well as important financial contributions by Poland's creditors. Bank project lending will be initiated after the approval of a Fund SBA and with the clear expectation of comprehensive and far-reaching rescheduling of existing debt-service obligations with all creditors, and possibly debt relief in the form of debt and debt-service reduction. The proposed SAL is being designed as part of a broad assistance strategy with built-in mechanisms (in terms of monitoring and financing assurances) and flexible adjustments to keep risks manageable.

II. Macroeconomic and Structural Issues and the Government's Program

A. Introduction

7. As mentioned above, economic reforms had been attempted before. They were all limited in scope, designed in a piece-meal fashion, and not fully implemented. They failed, ultimately because enterprises and workers were not exposed to full market pressure and financial discipline, and there was no institution exerting ownership interests vis-a-vis socialized enterprises.

8. The current reform program is more comprehensive and ambitious in scope, and the Government's commitment to systemic transformation has been proven by the far-reaching measures taken at the beginning of 1990. While the initial policy package comprises important stabilization and systemic reform measures, they are part of a larger and even more comprehensive, longer-term program which includes reforms of the enterprise sector and ultimately the commitment to large-scale transformation of ownership, with divestiture of existing enterprises to private (domestic and foreign) investors and

unconstrained development of new, privately owned activities in a market-based, competitive environment.

9. The task at hand is gigantic, and there are no historic precedents or blueprints as reform initiatives in other centrally planned economies have been incomplete and shied away from fundamental enterprise reform and divestiture to private owners. This points to the risks and time requirements. Stabilization and the introduction of market incentives (price liberalization, adjustment of exchange and interest rates) have to occur during a short period of time--as is the case with the shock treatment adopted by the Polish authorities at the beginning of 1990. Similarly the new "rules of the game" (exercise of ownership rights; framework for privatization; new bankruptcy legislation; demonopolization rules etc.) should be put in place as soon as possible, while the actual reforms of the financial system and the enterprise sector including privatization will take time as in many cases institutions have to be developed from scratch, requiring legislation and other regulatory acts and large-scale training (or retraining) of personnel. Careful design and sequencing of reforms is important as well as persevering implementation. Given the complexity of the reform process, the lack of experience, and the highly politicized nature of the economic reforms as corollary of the broader process of political liberalization and democratization, it cannot be expected that the process will be smooth and steadily progressing. Setbacks are to be expected as well as mistakes and course corrections.

10. The following description of the Government's economic program is by no means comprehensive. It focuses on those elements that are most directly conducive to macroeconomic stabilization and greater efficiency of resource use, with due consideration given to social equity as pre-condition for political feasibility and to environmental soundness as pre-condition for long-term sustainability. The emphasis is on economy-wide measures. Sector-specific measures, although needed to enhance the supply response and being considered by the Government, are not being discussed. The most noticeable omission may be agriculture which is 70 percent private-owned and has a high potential of relatively quick supply response. The sector is only covered to the extent that demonopolization and general liberalization of prices and foreign trade are expected to have beneficial effects.

11. In designing the adjustment program, one should take its evolving nature and the dynamic interface between the macroeconomic framework and the microeconomic components into account. The macroeconomic framework, in particular, has to be adapted to additional financial requirements stemming from enterprise and financial sector restructuring, social support measures, and priority government investment as they evolve. The program with its individual components discussed below is expected to contribute to a more stable macroeconomic environment, mobilization of domestic resources and greater efficiency; and thus to restored growth, improved balance of payments performance, and progressively restored creditworthiness. Against this expected outcome, the proposed $300 million SAL (Section IV) would support a limited number of specific actions and provide required balance-of-payment support within an acceptable overall financing plan (including debt relief or equivalent measures).

B. Macro-economic Issues and the Stabilization Program

12. During the course of 1989, Poland's macroeconomic situation rapidly deteriorated, with inflation accelerating to monthly rates of 40-50 percent after the August price liberalization measures, the fiscal deficit approaching five times the relative size of 1988, and the current account deficit of the balance of payments amounting to $2 billion. At the same time, production began to decline, with a drop in real GDP of about 2 percent.

13. During 1989, monetary policy was "tight" in the sense that real money balances declined through the year; this, of course, is to be expected during severe inflations as the public flees from nominal holdings of wealth. However, interest rates, although increasing through the year, lagged far behind inflation. As real interest rates became increasingly negative through the year, reaching minus 98-99 percent, the implicit tax on depositors increased substantially and financed a large subsidy to the enterprise sector. Additional quasi-fiscal resources were generated through the inflation tax levied on holders of currency (almost entirely households). At the same time, the Central Government budget deficit increased substantially as a result of rising subsidies and lagging revenues. It was approaching 10 percent of GDP on an annual basis, but was eventually held to about 7.5 percent through corrective measures taken by the new government, beginning in September 1989. It still represents a sharp deterioration when compared to the deficit in 1988 equivalent to about 2 percent of GDP. Weak fiscal and monetary management adversely affected the balance of payments despite a still highly restrictive and directly administered foreign exchange regime. The current account deficit increased from $585 million in 1988 to $2 billion in 1989. The non-interest current account surplus dropped from about $25 billion in 1988 to about $1.4 billion in 1989, which obviously did not allow to meet interest obligations on the order of $3-3.5 billion.

14. Expansionary fiscal and monetary policies were exacerbated by an overall expansionary incomes policy. During the first half of 1989, real wages increased slightly, received a major boost in September, followed by sharp declines in October and November and again an increase in December. Overall, real wages (as conventionally measured by deflating nominal wages with the CPI) increased by 7 percent during 1989 which translated into an increase in real private consumption of about 2 percent as compared to the decline of real GDP 2 percent.

15. As the current account of the balance of payments deteriorated in 1989, external debt continued to be a severe problem. Debt service due in 1989 reached $5.2 billion (of which interest $3.5 billion), compared to exports receipts of $7.6 billion. The continuing external debt burden clearly required new approaches if Poland were to have any chance to stabilize and reform the economy.

16. A sharp break with the past was required. A comprehensive macroeconomic program to address the country's severe problems was formulated by the Government at the end of 1989 with the help of the IMF and implemented at the beginning of 1990. This program has a heavy emphasis on stabilization,

but also introduced significant structural and systemic changes through price liberalization, reform of the foreign exchange regime, and a marked increase in interest rates (to a positive level in real terms, based on expected average inflation during January and February 1990). Farther-reaching adjustment elements are still being developed as work on the SAL progresses.

17. The stabilization program which is now being implemented is based on a virtually balanced budget; credit controls; positive real interest rates; price decontrol; a changed foreign trade and exchange regime with a fixed exchange rate after significant devaluation; and a substantial reduction in real wages (to be enforced through a tax-based income policy).

18. The fiscal budget for 1990 allows for a deficit equivalent to slightly less than 1 percent of GDP as compared to abut 7.5 percent in 1989. Monthly budgets will be prepared to ensure that even with high inflation expected at the beginning of the year (and the consequent difficulty of programming expenditures and revenues over the year) targets will be met.

19. Nominal interest rates have been raised sharply from 100 percent per year to 36 percent a month, above the projected average inflation rate for January and February of about 34 percent, with subsequent monthly rates to be determined on the basis of a number of criteria but with a strong concern for achieving positive real interest rates and making zloty savings instruments more desirable than previously. Money creation is limited by credit ceilings as well as a prohibition against monetary creation to finance any fiscal deficit.

20. Price controls, previously imposed on goods and services comprising 80 percent of GDP (for the first half of 1989 and 50 percent of GDP for the second half of 1989), have been lifted on all but goods and services accounting for about 10 percent of GDP (public transportation, energy, and a few other items are still controlled subsidized). This is a forceful step towards creation of a market economy.

21. The foreign exchange regime was completely changed to support the stabilization program. All current account transactions have been liberalized, except for restrictions on the transfers of dividends from foreign investment in domestic market activities (being progressively phased out over a period of time). All export proceeds are required to be surrendered but purchases of foreign exchange are freely allowed for current account transactions. Moreover, a fixed exchange rate at a substantially depreciated level (9500 zlotys/dollar vs. an official rate of 6500 zlotys/dollar at end December and an average rate of about 1400 zlotys per dollar for all of 1989) was established as an important anchor for the stabilization program. A parallel foreign exchange market will continue to exist for private, non-current account transactions. This market will also be an important factor in determining the adequacy of the official exchange rates. The margin is to be kept within 10 percent of the official rate. Greater deviations would trigger adjustments of domestic interest rates.

22. The new exchange rate regime will be important for balance of payments management which will nonetheless be quite constrained. Export

volumes are expected to only remain constant in 1990 despite the new exchange rate as the economy undergoes a huge restructuring in response to relative price and interest rate changes. The restructuring will lay the groundwork for sustained export growth in the coming years. Imports in 1990 are expected to grow by 10 percent in real terms. More than half of the growth could occur on account of food and other emergency imports funded by official transfers made available by the EC, the United States, and other donors. The restructuring needs of the economy will generate a large incremental need for imports.

23. In view of the balance of payments position, debt management will be a difficult issue. The resources freed by debt relief will play a critical role in supporting the adjustment effort. To prevent such relief from simply adding to future debt burden which is already among the highest in the world, some form of permanent debt relief (through debt and/or debt-service reduction or equivalent measures) needs to be implemented. The projections presented below show that Poland can achieve creditworthiness with the proper combination of good economic management and timely assistance from external creditors and donors.

24. Important systemic changes will have a considerable impact on the economy. As mentioned, prices were liberalized at the beginning of 1990, with items equivalent to about 10 percent of GDP left subject to price controls. Financial discipline of enterprises is expected to be strengthened by improved legislation allowing any creditor with unsatisfied claims to institute bankruptcy proceedings. Anti-monopoly legislation will also strengthened. The banking system is being modernized with a strengthening of regulatory and supervisory frameworks and with substantial technical assistance to strengthen personnel and improve procedures. These issues are dealt with in subsequent sections of this memorandum.

25. Short-term dislocations in economic activity are inevitable, and indeed, necessary if the economy is to be restructured. With the extensive changes being introduced (price decontrol, exchange rate changes,etc.) it is possible that up to 10 percent of the labor force (or even more) could become temporarily unemployed (a level seen at various times in many market economies, but unprecedented in Poland). Rapid implementation of an effective social safety net is essential to address this issue. The issue is dealt with in a later section of this memorandum.

C. Structural Issues and the Adjustment and Systemic Transformation Program

Fiscal Policy and Government Investment

26. Central government finances sharply deteriorated during 1989, largely as a result of increased subsidies to households and enterprises, and lagging revenues in line with accelerating inflation. While the central government deficit was heading towards 10 percent of GDP, the new Government took decisive measures during the latter part of 1989 thus managing to keep the deficit to some 7.5 percent of GDP.

27. The draft budget for 1990 is a sharp departure from the past: subsidies were cut by over 50 percent in real terms (to about 5 percent of GDP) from the previous year; the targeted deficit is sharply reduced to less than 1 percent of GDP; and specific (if still inadequate) programs such as enterprise restructuring and a rudimentary social safety net including unemployment insurance are introduced as part of the Government's adjustment program.

28. While subsidies are much reduced, thus significantly contributing to a reduction in the budget deficit, further reductions in the future are important for stabilization to succeed and market forces to play an increasingly larger role. Further, the composition of subsidies remains problematic on efficiency and equity grounds. Subsidies for transportation are actually increased as a percentage of GDP (to 1.3 percent), although these are somewhat regressive and in sharp contrast with the drastic reduction of food subsidies. A large subsidy for automobile purchases has been proposed, with the rationalization that Government needs to honor a past commitment to participants in a time-phased automobile purchase schedule. Another concern is the six-fold increase in coal subsidies to the population which would counteract the impact of price increases to an undesirable degree. This latter has to be seen in connection with housing subsidies which would also marginally increase from 1.9 to 2.0 percent of GDP.

29. The preparation mission that visited Poland in December 1989 raised these issues with the authorities. They were receptive to the proposed reductions, and the final version of the budget is expected to incorporate some or all of the proposed changes. Any savings resulting from further subsidy reductions could be used for higher allocations for high priority expenditures, in particular for social purposes (social welfare payments and unemployment benefits which are clearly underfunded.

30. Out of total investment, estimated at about 21 percent of GDP in 1989, the equivalent of about 1.6 percent of GDP takes place in the central government sector. This investment comprises 59 large, centrally promoted projects and a large number of smaller projects pursued by each of the 37 ministries and central institutions. The relatively low level of central government investment is the result of a long-term decline that started in the early 1980s. Centrally planned investment which provides the underpinning for most of the other investment, whether carried out by the socialized or non-socialized sector, was most affected. About one-third of that investment is allocated to infrastructure while the remainder is allocated to projects in basic industries such as coal, power, fertilizer, paper, foundry products, etc.

31. The low level of government investment raises a number of concerns. The rate of modernization of the capital stock is extremely slow, and a reformed and growing economy will face constraints from an obsolete and unbalanced capital stock. Currently, this is perhaps most noticeable in telecommunication and transport infrastructure. Moreover, as a result of low investment allocations, many projects were stretched out over time or left incomplete with negative effects on costs and, perhaps even more importantly, benefits. Two-thirds of the centrally planned investment projects executed in

1989 had been started before 1986, and their average time of completion was estimated at eight years. Substantial delays were observed, for example, in the completion of a gas pipeline and fertilizer plants.

32. Government investments are vital to the operation of the Polish economy. Their level has been already cut down considerably over the past several years, and all proposals for new large projects, whatever their merits, were rejected by the Government for lack of resources. Moreover, during 1990 these investments, in the past largely financed through bank credit (69 percent), may see their allocations drastically cut again, as Central Bank financing will not be available. This evolution is both costly and shortsighted, as these projects are expected to strengthen the output of goods and services during the nineties. The investment process should be more continuous, rather than totally dependent on the availability of residual financing. A careful review of the current and future level and structure of government investment is needed as well as of the decision making process.

Trade

33. Poland's exchange and trade regime in the past was highly distorted by the use of central foreign exchange allocations and a number of limited auctions. Both allocation mechanisms resulted in multiple and highly differentiated exchange rates which were tantamount to a haphazard set of export taxes, import tariffs, and import subsidies. In addition, there were explicit export subsidies and quotas, and a remaining state trade quasi-monopoly. Import tariffs, however, are low by developing country standards (although not of great relevance in the past given all the other interventions and distortions).

34. Given the lack of competition and the history of price controls firmly imbedded in the industrial sector, a complete opening of the trade regime has been deemed necessary by the authorities to introduce world price signals and competition into the incentive regime. As part of the stabilization program initiated at the beginning of 1990 and supported by the IMF, the Government took important steps towards the opening of the trade regime. The new regime eliminated explicit and implicit subsidies to exports and imports, and with the marked devaluation and unification of the exchange rate, significantly reduced the anti-export bias inherent in the previous regime. The trading system has also been opened considerably, eliminating practically all licensing of products and/or trading agents. While the new level of competition may reveal further deficiencies in the competitiveness of Polish industry, the more neutral trade regime is an essential complement to a liberalized price system which prepares the ground for supply response from more efficient firms and for greater private sector interest.

35. With the elimination of the managed trade regime, tariffs have become the main binding constraints of the import regime. Some additional actions in this area were taken with the new legislation, namely the elimination of the parallel system for non-commercial uses, and the elimination of tariff exemptions for imports from socialist countries, both considered by officials to have led to significant distortions in import decisions. However, even the

tariff regime as it now stands with an average level of about 10 percent and a range from 0-40 percent continues to have distortionary effects on resource allocation and an anti-export bias. Changes at the beginning of 1989, which lowered the tariffs for many capital and intermediate imports, while appearing to be a liberalization in terms of (import weighted) average tariff, may have actually increased the dispersion and distortionary effects of the tariff regime across activities (to be confirmed by further analysis).

36. Undoubtedly, one of the most important remaining sources of inefficiency stems from Poland's participation in CMEA trading, involving about 45 percent of Poland's exports and 48 percent of imports. While negotiations on CMEA reform among the participating nations are currently under way, the complexity of the system and sometimes conflicting interests among the participants make full-scale reform difficult in the near future. Still, the Polish Government considers the movement away from CMEA trading a high priority in restructuring the economy. As any Polish firms have been subsidized and insulated from competitive forces for many years through their participation in the CMEA trade, the shock of a sudden withdrawal from the CMEA system could lead to excessive additional disruptions in the industrial sector. A staged delinking could be necessary. A number of options are currently being explored. For example, an initial move to introduce dollar-denominated clearing arrangements with the Soviet Union is a step in the right direction toward grater transparency.

Financial Sector

37. Until recently, there was no financial system to speak of: commercial credit to enterprises was provided mainly through the National Bank of Poland (NBP), which was not a real Central Bank, and programs of subsidized directed credit existed for special purposes such as agriculture (food economy), housing, export development, and others. Highly negative lending rates (in real terms) were one of the prime vehicles to subsidize the enterprise sector. In early 1989, the institutional setting was reformed, and NBP was set up as a Central Bank, divesting itself of its commercial loan portfolio which was transferred to nine independent commercial banks. Interest rate policy also underwent substantial changes in stages since August 1989, except for interest on loans for housing and agriculture. The most significant change was implemented at the beginning of 1990: NBP's rediscount rate is now 36 percent per month for non-preferential credit, slightly higher than the projected average inflation for January and February.

38. There is still no appropriate framework and institutional capacity to run the new system, and the loan portfolios (particularly the central investment portfolios) are plagued with problems stemming from the enterprise sector. Prudential regulations and procedures which are still being developed on the basis of the 1989 Banking Law and recent amendments are applied in a limited manner. The Bank played an important role in convincing the authorities of the need for prudential bank supervision, inter alia, through a two-week seminar in January 1989. A lot needs to be done to fully develop the system and make it operational, particularly in the form of training. Further amendments or regulations to the Banking Law are also required. NBP has initiated a program to strengthen its institutional capabilities, particularly

as regards the formulation and implementation of monetary policy, and the supervision of the banks. These efforts are being supported by the Fund and the Bank. More needs to be done with regard to the development of the banking system. This will be addressed by the Bank in coordination and cooperation with other institutions.

39. The reforms initiated over the last years, in particular the new Banking Law (January 1989) and the liberalization of interest rates, set the stage for the development of an efficient banking system. At present, however, existing banking institutions still suffer from major distortions inherited from past policies. Their major weaknesses are: a lack of autonomy, and an excessive reliance on Central Bank refinancing and government back-up; the extreme segmentation of their activities, with lack of real competition; a general lack of banking skills needed in a market economy environment; small branch networks; and an inadequate financial structure. An initial action plan for strengthening banking institutions could be articulated around three components: development of institutional capabilities; financial restructuring of existing institutions; and measures to enhance competition in the system.

40. The inability of existing institutions to conduct efficient banking activities in a market-based environment requires the <u>development of stronger institutional capabilities</u>. These measures would include inter alia: the preparation and implementation of new accounting standards and procedures, to be supported by adequate computer and communication equipment to improve processing efficiency; the strengthening of staff skills through the development of broad-based training programs for the banking and accounting professions; and additional support through technical assistance arrangements with relevant foreign banks.

41. An analysis of banks' balance sheets reveals the vulnerability to changes just introduced through the implementation of the stabilization package at the beginning of the year. The main risks relate to foreign exchange exposure, loans to public enterprises, mismatch between deposits and credits, and exposure on the interbank market. Given the current structure of ownership, it is obvious that the Government would be expected to step in and provide the required back-up in case of a major failure. It is not obvious, however, that it would have the means to do so in all circumstances, particularly as regards foreign liabilities and deposits in foreign currencies. Before <u>financial restructuring</u> could take place (which is a medium-term proposition), the following prior actions and developments would be required: full audits according to international standards; adoption of clear policies regarding the restructuring of enterprises in the socialized sector, and the respective role of banks; and preparation of multi-year business projections for banks, obviously assuming a more stable macroeconomic environment with low inflation. Suitable development and restructuring strategies should be elaborated for individual banks during the first half of 1990 and implementation could be initiated in the second half. Technical assistance is likely to be needed. Suitable sources have yet to be identified.

42. The gradual "de-specialization" of banks, the partial convertibility of the zloty, the relaxation of foreign exchange controls, and the entry of foreign banks will have a profound impact on banks currently involved in foreign currency transactions. As regards domestic banking, the changes in the Banking Law permitting a move towards universal banking, the liberalization of the interest rate policy, stricter limits in accessing the refinancing window, reforms in the system of interest subsidization, and the establishment of a number of new banks in recent years have set the stage for increased competition among domestic banks. More intensive competition would also be created through an expansion of branch networks, with beneficial impact on the satisfaction of domestic financial needs. Some financing needs previously covered through the centralized allocation process will require specific attention. This includes housing finance, agriculture, and the so-called central investments. Although directed and subsidized credit would continue in the short-term, albeit on a reduced scale, the banking sector--and to an increasing extent the financial markets--will gradually become the main source of financing for a number of these investments. The recently reestablished Bank for National Economy is expected to play a leading role in the transitional process.

43. The concept of prudential bank supervision has gained wide acceptance in Poland as a necessary instrument of public policy to ensure the health and stability of the financial system. As a first step, a department of bank supervision was created within NBP, with an authorized staff of 60 persons and current employment of 46 persons. While the development of this nascent organization is proceeding in a reasonable manner, several important issues are emerging: staff, organization, and skill weaknesses; the coordination and provision of technical assistance; and the appropriate model of bank supervision for Poland. As should be expected at this early stage, skill levels are weak and staff have little banking experience, particularly in assessing credit quality, foreign exchange risks, and overall financial conditions. To address these concerns, a program of technical assistance has been suggested by the Polish authorities and is being implemented with IMF support, in consultation with the Bank.

44. The Banking Law and the Act on NBP were promulgated on January 31, 1989. Proposed amendments to these laws were to be acted upon before the end of 1989. These laws provide a reasonable basis for regulation of the banking sector. However, more needs to be done to complete the body of laws, rules, and regulations for banking. Among the desirable additions or changes in laws or regulations, necessary for prudential aspects of banking, are the following: Powers authorizing banking supervisors to mandate provisions for possible credit losses and write-offs of assets; exposure limits designed to prevent the concentration of risk in a single borrower or group of related borrowers based on the bank's own capital funds; minimum capital adequacy ratios; powers authorizing bank supervisors to declare a bank insolvent, close it, replace management, eliminate the interest of shareholders, and purchase, transfer, or sell problem assets; rules governing the licensing of new banks; minimum scope and content of financial statements; and enforcement actions. For those aspects of law and regulation with which banks could not immediately comply (e.g., reasonable lending limits based solely on own funds, minimum

capital, etc.), it would be desirable to establish a phased program under which banks would have to meet certain targets by specific dates.

45. An urgent priority is the need to transform and develop accounting practice and independent external audit for both banks and enterprises in accord with the practices of the European Community and best international practice. To accelerate the development of an accounting and auditing framework for both banks and enterprises in Poland, the Polish authorities are in the process of mounting a technical assistance program with the Bank and possible US and UK support.

Enterprise Restructuring, Privatization, and Private Sector Development.

46. Except for agriculture, social/public enterprises account for the bulk of domestic production in the goods-producing and service sectors. Owing to the centralized nature of the decision-making process with regard to the allocation of the physical and financial resources in the past and an intricate system of direct interventions based on specific subsidies and taxes, enterprises lacked the incentives to work efficiently and make profits. Moreover, given the distortions of the trade and pricing systems, financial results--to say the least--were poor indicators of efficiency. With regard to some subsectors of manufacturing industry, it is estimated that about 30 percent is not competitive (based on a Bank study which used 1986 data and some related work now being done to get a more up-to-date assessment).

47. Substantial progress has been made in delegating decision-making to the enterprise level and thus in enhancing management autonomy. However, the absence of a clearly identified owner capable of exercising interests and holding management accountable (e.g., for financial performance) remains a major problem. The Government recognizes that reforms in this area are a vital element in instilling the much needed financial discipline in the enterprise sector. This remains a critical issue regardless of the Government's privatization plans since, in the medium term, an important proportion of the enterprise sector is likely to remain wholly, or in part, in the social ownership sphere as privatization will take time.

48. The stabilization cum adjustment program supported by the IMF, with tight monetary and fiscal policies, the imposition of a hard budget constraint on enterprises, and fundamental changes of the exchange regime and adjustment of the exchange and interest rates, is expected to have a major impact on enterprises in all sectors and, directly and indirectly, on the financial sector. At this stage, neither the magnitude of the overall impact, nor the amount of resources that could be provided to the enterprise sector through the budget or other sources of non-inflationary financing during a transition

period are known [1]. Many enterprises will not be able to continue to operate unless effectively restructured with specific financial support. In many cases, restructuring support may not be economically justified, and total or partial liquidation may be the appropriate response. In other cases, restructuring operations may be well justified, with a view to continue to operate the enterprises under public ownership (with more clearly defined ownership and exercise of owner interests) or with a view towards ultimate (total or partial) divestiture to the (domestic and/or foreign) private sector. Depending on individual enterprises, restructuring might have to precede privatization or be part of a privatization strategy. In any event, enterprise restructuring and privatization are seen as part of a broader process towards a decentralized, market-based economic system with competition to stimulate efficiency and growth.

49. A new foreign investment law was enacted in December 1988 and amended in December 1989. The law has greatly improved the investment climate: there are no limitations to foreign ownership, and only minor restrictions (being progressively phased out over time) apply to dividend transfers for domestic market oriented activities. In addition, the Government has a number of legislative initiatives under preparation in the area of enterprise ownership, privatization, financial discipline through new bankruptcy rules, competition, and social enterprise restructuring. This complex legislation has to be seen as one package that would largely determine the "rules of the game" for the enterprises in the new environment of a market economy. A key piece of legislation is the proposed "Law of Commercialization". In sharp contrast to current practice with a rather nebulous definition of ownership of social enterprises, the December 1989 draft of that law proposed to re-establish the State as the owner of the social enterprises. This is an important and necessary intermediate step for enterprise restructuring including possible privatization. The draft law (as it stood in December 1989) had some important shortcomings which would need to be overcome for it to become an effective tool, particularly since state ownership of the majority of enterprises is likely to continue for some time to come as privatization may be slow for a variety of reasons. At the same time, the design and implementation of an effective privatization strategy through the office of the Plenipotentiary of Privatization also constitutes a key element of the enterprise strategy. Between now and Board presentation, we would ascertain that the legislative package would provide an adequate basis for enterprises to operate efficiently and particularly prepare the ground for increased private ownership of enterprises. Particular emphasis will be laid on greater

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1 Although very difficult given the data situation and the magnitude of changes introduced by the January 1990 policy package, some quantification is needed to assess the changing aggregate financial situation of the enterprise sector and its possible repercussions on the macroeconomic framework. The draft 1990 budget (December 1989 version) included a small reserve for possible financial transfers to the enterprise sector. If this reserve turned out to be inadequate, the budget deficit might increase, either directly because of higher transfer payments or indirectly because of higher unemployment payments to people that would lose jobs as enterprises go out of business.

competition in agricultural marketing and distribution of inputs so as to ensure that price liberalization reaches the farm level and stimulates production.

50. While the change in the exchange regime contributes to trade liberalization and greater import competition, the domestic economy is highly monopolized, rigid, and subject to restrictive practices. The Government is committed to developing legislation that will strengthen market behavior in the economy, through the establishment of a Demonopolization Agency which would be in charge of the enforcement of competition policy. The effective enforcement of this legislation will require a strong institution which would need support to become operative. Moreover, dismantling of large conglomerates which comprise about two-thirds of industrial employment, may be difficult and time consuming. Technical assistance from the OECD to develop action programs towards greater competition is under consideration.

51. The current economic and financial situation of existing social enterprises is highly uneven, and the stabilization and adjustment program will again have a differentiated impact on individual enterprises. Given this situation, there is a need for some form of enterprise restructuring unit or agency which would help distressed enterprises prepare and implement restructuring plans. Legislation is being prepared to create a Fund for the Assistance of Enterprise Transformation which might serve such a function. The restructuring unit should be established as early as possible in order to assist eligible enterprises which are affected by the systemic reforms. The unit should benefit from foreign technical assistance in a broad array of financial and management techniques. Moreover, credit should be available within the monetary program, possibly to be complemented by temporary transfers through the budget and by other resources. For the successful operation of such Fund or unit it would be particularly important that its managers be held accountable for the results of enterprise restructuring programs. Creating direct financial interest could be part of an incentives scheme. The approach to enterprise restructuring is obviously closely linked to the ownership question being addressed through the proposed Law of Commercialization.

52. The need for a special framework, as envisioned above, derives from the fact that in the current state of transition toward a market-based, mixed economy, Poland lacks the infrastructure, institutional/technical capacities, and precedents (demonstration cases) required for restructuring to take place in a market-driven manner. Importantly the banking system, which would otherwise be expected to play a major role, is not yet strong. The overall framework for restructuring would be based in an overall strategy, which would address the following issues: the goal of the restructuring effort and the pace at which it should proceed; the possible linkages and complementarity between the proposed changes in ownership relations, restructuring and demonopolization efforts; the scope and sequencing, if any is foreseen, by sectors, subsectors (major ailing industries may need to be restructured within the context of a strategy for the whole subsector) or category/nature of enterprises with special regards to the roles envisioned for small and medium enterprises, the private sector and foreign investors; the relative importance of privatization; the role of the Government (and of budgetary

resources) in restructuring and in providing the required "safety net"; and the role of financial intermediaries.

Social Safety Net

53. A number of social issues have emerged which are likely to be crucial for the success of the transformation process and long-term growth and prosperity. While by no means comprehensive, the list includes issues on which there was consensus with the Government that they are the most urgent ones: improving the functioning of the labor market, including measures to improve placement of people seeking employment, increase labor mobility and to develop wage determination; upgrading systems to monitor employment trends; the financing and administration of a system of unemployment benefits and social assistance for those likely to be most critically affected by the economic reform process; upgrading training and retraining to cater both for the retraining needs of the unemployed, and the new skills which will be required to support new investments; and restructuring of the health system, including financing of health services.

54. The impact of economic adjustment on the labor market is likely to come in two successive phases: during stabilization, when restrictive fiscal and monetary policies aiming at curbing inflation will be applied; and during restructuring, when the Government will conduct a restructuring and privatization program, and close unprofitable plants as domestic and foreign competition gradually increases. The impact on the labor market will be reflected in both a decline in real wages and open unemployment. Total unemployment may reach 10 to 15 percent of the labor force, and its peak may be reached by mid-1991, assuming that the restructuring program starts in earnest by June 1990. In addition, unemployment may arise from either efficiency gains or from skill mismatch. Additional unemployment may also result from increases in labor force participation which would be quite normal in a period of high unemployment and low real wages, due to an attempt (by secondary wage earners) to supplement family incomes.

55. Increasing labor mobility across industries, as well as geographical areas is crucial over the medium and longer term, which also includes improved housing. In the short run, the establishment of an adequate social safety net is indispensable. Three crucial issues need to be resolved in developing a modern system of unemployment benefit and social assistance: the structure of benefits, particularly whether benefit should be set at a flat rate, or calculated as a fraction of previous earnings, which has important implications for work incentives and financing; the administration of benefits, in particular the ability of the system to deliver benefits effectively, given the likelihood that the number of unemployed will rise sharply, at least in the short run; and the finance of the system, including realistic cost estimates, and decisions as to how benefits should be funded.

56. Along with the stabilization package, the Government enacted a new labor law which, inter alia, included the establishment of a Labor Fund, to be financed with a 2 percent payroll tax and to be administered outside the central government budget. In addition, the 1990 budget also allocates the

equivalent of about 1 percent of GDP to social welfare for a support program which had not been clear in December 1989. The Labor Fund as originally proposed and implemented in connection with the stabilization program at the beginning of 1990 is likely to be inadequate to handle the number of unemployed to be expected. Moreover, the proposed benefits are based on decreasing fractions of previous earnings with serious negative implications for work incentives, support of the poorest, and overall financing. Some revisions of design and administration are probably needed to make the scheme an effective social support tool. Similarly, important issues need to be addressed in the design and implementation of an effective system of social assistance. Both measures have major implications for the budget. As of December 1989, the proposed allocations for unemployment and welfare benefits amounted to about 1.6 percent of GDP (1 percent through the budget; 0.6 percent outside the budget for the labor fund) as compared to a minimum estimated at about 4.5 percent of GDP. Additional financing will be needed through both domestic efforts and external support.

57. The restructuring of the system of training/retraining is also critical to ensure that workers made redundant by the stabilization program and enterprise reform have access to appropriate retraining opportunities to equip themselves for new employment, and new entrants to the labor market have appropriate skills. Special incentives for retraining could be provided through a bonus in connection with unemployment benefits. The existing training/retraining arrangements for blue and white collar workers are implemented through a wide range of associations and institutions. This training is largely reactive, responding to the specific requirements of the local community or industry, and tends to be over-specialized. However, the present arrangements do provide a nucleus which could be suitably strenghtened by improving training structure, equipment, course design, and by upgrading teachers to provide a flexible training/retraining system. In addition, a range of new training programs in business administration, accounting, human resource management, etc. needs to be developed to cater to the needs of the small business and service sectors.

58. In order to support a restructured industrial sector and technological advances, the Government also plans to reform the education system. The proposed reforms would among other things: reduce the number of trades in secondary vocational schools; improve post secondary vocational education; transfer responsibility for vocational schools from the Ministry of Education to enterprises and increase the extent of in-plant training; and broaden and strengthen secondary general education, particularly in scientific, technological, and mathematical subjects.

Environmental Issues

59. The severe degradation of Poland's environment can be attributed largely to systemic problems associated with central planning--industry's high share of national output, with a bias towards heavy industry and high material and energy intensity; neglect of operation, maintenance, rehabilitation and modernization; and a constant shortage of investment funds, especially for "non-productive" purposes such as pollution monitoring and abatement. In

addition, the pattern of production and consumption reflects the cumulative impact of inefficient pricing policies, particularly in public utilities--water, sewerage, heat, gas, electricity. The greatest negative impact on the environment arises from Poland's extreme reliance on under-priced coal and lignite for primary energy consumption.

60. Environmental goals need to be incorporated into the broader "efficiency" goals as an integral part of public utility pricing reform, and the current approach to pollution pricing, enforcement of environmental standards, and specific abatement investments needs to be reviewed. The modification of current practices in these areas may have serious consequences in determining the viability of enterprises as they undergo restructuring and reform. The proposed SAL could also address these consequences as part of its emphasis on an adequate framework for liquidation, restructuring, and divestiture based on appropriate screening and assessment of enterprises. Pollution charges should be regarded as part of the normal production cost. Enterprises that cannot adjust to this normal cost structure within a reasonable period, and without subsidies, should be considered as candidates for restructuring.

61. In practice, the existing system of fees and fines is effectively nullified by the low levels of payments (much lower than the clean-up costs), and by the lack of adequate monitoring. Fees and fines provide insufficient incentives to encourage enterprises to manage their operations more efficiently, to switch to less polluting sources of energy, or to install pollution control equipment. Many enterprises seem to ignore the environmental regulations altogether, while the remainder prefer to pay the fines and to continue with gross violations of the emission standards. In fact, a significant part of Poland's difficulties with environmental protection can be explained by the existence of ad-hoc exemptions and unclear negotiated settlements and agreements between enterprises and Wojewodships.

62. Environmental protection investments in Poland are well below government targets; plans call for substantial investments in areas such as sewage treatment, coal cleaning, mining effluent desalination, and flue gas desulphurization. These programs are likely to remain largely unfinanced until there are major changes in public utility pricing; pollution pricing, monitoring and enforcement; enterprise behavior in the socialized sector; and the process of defining priorities for centrally-financed investments. At present, the haphazard process of defining investment priorities hampers efficient resource allocation and effective mitigation of environmental problems. The most cost-effective short-term investments in environmental protection will be those that provide environmental benefits as a "free" by-product (e.g. coal washing).

63. The foregoing issues suggest the need for measures, to be taken by the Ministry of Environment and Natural Resources in collaboration with the

Ministry of Industry and other Ministries as required, in association with the proposed enterprise transformation and restructuring process. The following would be key policy measures: review of the current system of fees and fines and adoption of a revised system that would encourage enterprises to manage and reduce emissions; adoption of revised emission (air) and effluent (water) standards/permits, region by region, for all new pollution sources; design of a legally enforceable process of negotiations for phased implementation of revised emission/effluent standards for existing enterprises, region by region, taking into account proposals for restructuring and/or privatization; and elimination of the proposed tax holidays for environmental investments in the corporation tax system. Such tax breaks encourage a wasteful use of resources for end-of-pipe environmental control technologies.

64. Under the proposed Environment Management Strategy Project, technical assistance (including training) is envisaged in order to support the Government in the development of the above policies. The proposed project also addresses air and water pollution, and it includes a systematic environment-and-efficiency review of selected enterprises. This review would be carefully coordinated with enterprise activities under the SAL.

III. Medium-Term Outlook and External Financing Needs

65. Poland faces an unprecedented economic management problem having to stabilize the economy, introduce far-reaching systemic reform measures, alleviate its external debt burden, and secure the external financial support for its reform program. Poland is currently not creditworthy and does not attract substantial inflows of voluntary commercial capital. For the program outlined above to succeed massive external financing is required, mainly in the form of debt rescheduling but also importantly through debt and debt-service reduction (or equivalent support) and fresh capital, including foreign investment.

66. A base case scenario, which might materialize in the absence of a coherent stabilization and forceful structural reform program, was constructed and is summarized in Table 1. Under this scenario, output might drop by 5 percent during 1990 with a further 2 percent decrease in 1991, and with only a modest recovery with GDP increases of 2-3 percent during the rest of the 1990s. In this scenario, per capita consumption would decrease by a total of 4 percent during 1990 and 1991, with 1-2 percent per year increases during the remainder of the 1990s. The current account of the balance of payments would remain in deficit during the 1990s, although with improvements after 1995. This is clearly an unacceptable scenario, though one which is possible in the absence of an effective structural adjustment program.

TABLE 1

Base Case

Growth of Output and Expenditure (% p.a.)

	1988	1989	1990	1991	1992	1993	1995	2000
GDP Growth Rate	5.1	-2.0	-5.0	-2.0	1.0	2.0	3.0	3.0
Per Capita Consumption Growth Rate	2.0	3.0	-3.0	-1.0	0.0	1.0	3.0	2.0
Fixed Investment	5.5	0.0	-4.0	-2.0	-3.0	1.0	3.0	3.0
Imports GNFS	2.6	4.2	8.9	2.8	1.7	2.9	4.0	3.5
Exports GNFS	5.2	1.0	0.5	4.3	4.7	4.9	4.9	4.6
MGNFS (convertible currency)	12.0	11.0	10.7	1.0	0.5	2.0	4.0	3.2
XGNFS (convertible currency)	11.0	-2.0	0.0	5.0	5.0	5.0	5.0	5.0
Memo Items Current Account Balance (billions of dollars)	-.6	-2.0	-3.0	-3.1	-3.1	-3.3	-3.3	-1.9

67. With the stabilization program complemented by the structural reform program as described above, Poland could avoid the decreased levels economic activity of the base case scenario. With appropriate enterprise restructuring, output growth could resume in 1991 and eventually reach levels of 5 percent per year, as a substantial reallocation of resources in response to market signals would enable significant increases in productivity. Per capita consumption could begin to increase in 1991 and annual increases on the order of 3-4 percent could be obtained in the second half of the decade. Export growth (convertible currency) of 8-10 percent would be needed to sustain the balance of payments, and could be achieved with further reduction of the anti-export bias in the incentives system. However, for 1990, it is prudent to project no export growth as enterprises seek to adjust to higher interest rates and as markets are subject to large changes related to price liberalization and other reform measures.

TABLE 2

Improved Case

Growth of Output and Expenditure (% p.a.)

	1988	1989	1990	1991	1992	1993	1995	2000
GDP Growth Rate	5.1	-2.0	-5.0	2.0	3.0	5.0	5.0	5.0
Per Capita Consumption	2.0	3.0	-4.0	1.0	2.0	3.0	4.0	4.0
Fixed Investment	5.5	0.0	-5.0	2.0	3.0	5.0	5.0	5.0
Imports GNFS	2.6	4.2	7.5	2.9	3.5	3.5	5.0	4.7
Exports GNFS	5.2	1.0	0.5	6.6	7.2	6.9	6.4	5.2
MGNFS (convertible currency)	12.0	11.0	10.7	1.0	2.1	3.2	5.9	5.4
XGNFS (convertible currency)	11.0	-2.0	0.0	10.0	10.0	9.0	8.0	5.0

68. In this scenario, the current account deficit would deteriorate from $2 billion in 1989 to $3 billion in 1990, with subsequent improvement. Interest due would increase by $500 million to $3.5 billion and would be an important element in the deterioration of the current account balance. At the same time, imports would increase by $1 billion to $8.5 billion in 1990; capital imports would need to support restructuring, intermediates to spur production, and emergency food imports to counteract market disruptions. Such a deterioration in the current account, while necessary from a macroeconomic management and adjustment perspective, would seriously jeopardize Poland's creditworthiness for the foreseeable future. Therefore, some form of permanent debt relief (or permanent interest reduction or equivalent measure) would be needed to allow Poland to improve its external financial position. This permanent debt relief should amount to approximately $5.7 billion from 1990-1992 and $5.4 billion from 1993-1995. Without such permanent debt relief the current account deficit would reach 11 percent of GDP in 1990, and the current account would only be balanced in the late 1990s. With permanent debt relief of the magnitudes indicated, the current account deficit could decrease rapidly from a peak of 4.7 percent of GDP in 1990 and could be eliminated by 1993.

TABLE 3

Savings/Investment Balance: Improved Case (% of GDP)

	1988	1989	1990	1991	1992	1993	1995	2000
Government	-0.3	-7.5	-1.0	-1.0	0.0	0.0	0.0	0.0
Enterprise Sector	-5.8	-3.3	-5.7	-4.0	-3.3	-2.9	-2.7	-3.0
Households	6.0	8.0	2.0	3.3	4.0	3.0	4.0	6.0
Total Net National Savings	-0.1	-3.8	-4.7	-1.7	-0.7	0.1	1.3	3.0
Current Account Balance	-0.1	-3.8	-4.7	-1.7	-0.7	0.1	1.3	3.0
Current Account Balance without Permanent Debt Relief	n.a	n.a	-10.9	-8.4	-7.1	-5.9	-3.3	0.8
Effects of Permanent Debt Relief	n.a	n.a	6.2	6.7	6.4	6.0	4.6	2.2

69. Under this scenario, Poland would run a trade deficit from 1990-1992, and then develop a substantial trade surplus for 1993-1995 on the order of $5 billion. Transfers will continue to play an important role, with official transfers supplementing the large (though decreasing) private transfers. Private transfers are expected to decrease as the economic situation in Poland improves in the medium term. The non-interest current account surplus would increase from about $4.2 billion to $8.8 billion from the period 1990-1992 to 1993-95. The projected increase in reserves of about $2.3 billion during 1990-92 is needed because freely usable reserves were dangerously close to zero at the end of 1989. This projection does not include use of the $1 billion stabilization fund which has been organized to support the

stabilization program and maintenance of the nominal exchange rate. Fresh capital disbursement would depend importantly on IMF and IBRD support, although other sources would account for about half of disbursements during 1990-1992 and about two-thirds during the period from 1993-1995.

TABLE 4

Tentative Financing Plan: Improved Case

(million of $)

		1990-92 (cumulative)	1993-95 (cumulative)
1.	Trade Surplus	-542	4,717
2.	Transfer From Abroad	3,450	2,139
3.	Net Service Receipts (excluding interest)	1,305	1,942
4.	NICA* (1+2+3)	4,213	8,798
5.	Interest Due	11,475	13,198
6.	Amortization Due	9,356	14,936
7.	Total Debt Service Due (5+6)	20,831	28,074
8.	Change in Reserves	2,325	-278
9.	Financing Needs (7+8)-4	18,943	18,998
10.	Financing (11+12+13)	18,943	18,998
11.	Direct Foreign Investment	500	1,986
12.	Fresh Capital Disbursement	5,246	5,500
13.	Financing Gap:	13,197	11,512
	of which: (a) normal rescheduling	7,434	6,153
	(b) permanent debt relief	5,763	5,359

*Non-interest current account surplus.

IV. The Proposed SAL

A. SAL Objectives

70. The SAL will be conceived as the first in a series of adjustment operations (including SECALs and possibly hybrid loans) over a period of say 5-10 years. The macroeconomic framework for the first SAL will be essentially given by the program supported by the IMF. At the same time, we envisage broad understandings--to be reflected in the Government's letter of development policy--on a medium-term framework and financing plan along the lines discussed in Section III which--based on reporting arrangements with the authorities to be specified in the loan agreement--would be monitored by the Bank as important elements within a multi-year association (obviously

maintaining flexibility to take the evolving nature of the program as well as the dynamic interface of the macro and microeconomic level into account). Similarly, specific programs and policy measures will be designed in a way that continuity during a multi-year period beyond the time horizon of the first SAL can be ensured, e.g., through action programs being developed during the execution of the preceding loan. Actual reform measures could be supported in the future through a variety of instruments including SECALs, hybrid loans, or sector investment loans.

71. The reform program to be supported by the proposed SAL would essentially pursue three broad objectives: stabilization, structural reform towards the establishment of a market economy to improve resource allocation and restore growth, and the progressive restoration of creditworthiness (including adequate burden sharing among creditors). The program would go beyond the stabilization program agreed between the authorities and the Fund. The emphasis will be on structural and systemic reforms needed to improve resource allocation and growth/supply response with social equity. In designing the macroeconomic framework and financing plan, the multi-year nature of the reform process and the uncertainties during the transition from the old central planning to a market-based system will be taken into account.

B. Components and Conditionality

72. Individual SAL components are derived from the broad description of the program in section II. While leaving the precise scope of the SAL supported reform program still somewhat open at this stage, it is proposed--within an adequate, medium-term macroeconomic framework and financing plan--to concentrate on reform initiatives in the following core areas which would contribute to the above objectives:

(i) enterprise restructuring, privatization, private sector development, with emphasis on appropriate legislation to define the "rules of the game"(including privatization), the establishment of an adequate institutional framework for enterprise restructuring, and some environmental policy backing;

(ii) financial sector reform, with emphasis on improved banking regulation and supervision, introduction of adequate accounting and auditing standards (also applicable to non-financial enterprises), and strengthening and ultimately phased restructuring of the banking system; and

(iii) social safety net, with emphasis on adequate unemployment benefits and a program of minimum social assistance.

Supplementary measures could be envisaged in the fiscal area (further reduction of subsidies to ease the financing of the social safety net, agreement on a central government investment program, the preparation of a tax reform, and eventually agreement on the 1991 budget) and in trade policy (adjustment of tariff structure and reform of CMEA trade arrangements). One should, however, keep in mind that the initial reforms in these two areas that were implemented as part of the stabilization package at the beginning of the year are important by themselves and far-reaching and mark a radical departure from the past.

73. The proposed three core components are crucial for the success of the overall stabilization and reform program. The enterprise and financial sector components are designed to establish financial discipline at the enterprise level which is indispensable to eliminate the quasi-fiscal deficit which, in the past, was the main source of monetary expansion. The social component, in turn, is needed to mitigate the impact on employment and income and make the program politically feasible. Details of the proposed components are provided in table 5 and in the annex.

74. The macroeconomic framework and financing plan for 1990 are largely given by the IMF standby arrangement, with some flexibility in the second half of the year for which targets are only indicative at this stage. The indicative character obviously applies even more to the medium-term projections which will have to be revised as the program evolves. The letter of development policy will include a number of key macroeconomic variables which the Government would report to the Bank on a regular basis and which would be monitored closely, with possible implications for disbursement/tranche release or future adjustment lending. Variables to be monitored would be both of a performance (outcome) nature such as inflation and the balance of payments and of a policy nature such as interest and exchange rates and the budget deficit (based on an adequate level and structure of expenditures). Within the overall framework as envisioned in the projections presented in section III (which obviously needs further work, particularly with regard to the debt strategy and financing plan), specific numbers for these variables will be discussed with the Government and reflected in the letter of development policy, again with the proviso of firmer understanding at the time of second tranche release.

75. The macroeconomic framework will critically depend on the financing plan. The overriding concern in the progressive restoration of creditworthiness which will require exceptional debt relief or equivalent measures. Work will be initiated in parallel with the processing of the proposed SAL to explore Poland's needs and possible options with regard to debt and debt-service reduction. Moreover, cofinancing (particularly at concessional terms) will also be further explored with the Japanese Ex-Im Bank and other bilateral institutions.

76. More work is obviously also needed in other areas to add specificity to the Government's program and understandings with the Bank. This applies in particular to the legislative and regulatory framework for enterprise restructuring, privatization, and private sector development, the financial sector, the social dimension, and trade.

77. The attached (tentative) policy matrix (Annex) provides an overview of specific objectives and actions to be reflected in the letter of development policy. The matrix is relatively broad and includes policy actions

beyond the proposed scope of the SAL. Specific SAL conditions would be more limited, along the lines presented in Table 5.

C. Loan Amount, Disbursements

78. The loan would be made to the Government. The proposed loan amount is $300 million to be disbursed in two tranches, the first during the course of the second half of 1990, and the second during the first half of 1991. While $300 million is barely adequate to meet Poland's balance of payments needs not covered through financing from other sources including debt rescheduling, even a substantially higher loan amount for this first fast-disbursing operation would not significantly reduce the need for debt rescheduling and relief in the form of debt and debt-service reduction. It is important to keep a medium-term lending perspective in mind, with additional fast-disbursing loans (including possibly hybrids), but with even greater emphasis on traditional investment lending in support of Poland's infrastructure and technology needs.

79. Disbursements and procurement would follow standard procedures. Counterpart funds would not be earmarked but would be available for the financing of the social safety net within agreed overall budget limits.

V. Bank Assistance Strategy, Burden Sharing and Aid Coordination

80. The Bank's assistance strategy is designed to support Poland's development objectives--namely to improve the efficiency of the economy and to upgrade socio-economic conditions through the market-oriented policies the Government has adopted. To reach these objectives, the Bank is assisting in implementing programs to address Poland's key development issues--the reform of the economic system, restructuring the productive base and improving creditworthiness.

81. As the reform and adjustment process is a complicated and multifaceted endeavor, World Bank assistance is taking various forms and will have to be managed in a flexible manner. Through our economic and sector work, we are helping in the exploration and definition of overall reform and development policies. Through the preparation of projects, we are helping to increase the impact of the selected reforms and strengthen the programs as well as those institutions required to carry them out. Assuming that the stabilization and restructuring program will be forcefully implemented by the Government and strongly supported by Poland's current creditors, the Bank is preparing a stock of projects which will contribute to: the supply of goods for hard currency markets (industrial Exports, Agroindustrial Exports, and Energy I); increasing the economic, financial, institutional and technical efficiency of key infrastructure sectors (railways, telecommunications, energy and district heating, housing); and the development of operational and institutional conditions to implement the agreed policies (SAL I, industrial restructuring, financial system development, agriculture development, and human resources). These proposed projects (including technical assistance as needed) will contribute (directly and indirectly) to the needed supply response of the economy to the stabilization and adjustment measures and are (or will be) designed to encourage decentralization and the private sector.

TABLE 5

SPECIFIC ACTIONS, TIMING, AND PROPOSED SAL CONDITIONALITY

Board Presentation/Effectiveness (Mid-1990)	**Second Tranche Release** (Early 1991)	**Beyond Second Tranche** (Basis for future fast-disbursing lending; to be reflected in terms of broad intentions in the letter of development policy.)
Macroeconomic Program (and related micro reforms)		
1. **Agreement on medium-term macroeconomic framework with reasonable adjustment path of current account and agreement on** strategy towards multi-year external financing plan (along the lines of projections). Key policy variables to be agreed: interest rate, exchange rate, fiscal deficit (with reasonable expenditure level and structure).	1. **Adherence to framework, based on extensive review, and satisfactory progress with external financing program (including debt relief or** equivalent support).	1. Adherence to framework and **satisfactory progress with external financing program** (including debt relief or **equivalent support).**
2. Monetary Policy /Financial Sector Reform a. Reasonable interest and exchange rate policy (to **make zloty instruments attractive and exports competitive).**	2a. Continued **reasonable exchange** and interest rate policy and progress in phasing out specific interest subsidies.	2. Continued reasonable exchange and interest rate policy and complete elimination of interest subsi-dies, except for special, well-justified cases.
	b. Implementation of prudential bank supervision based on acceptable regulations.	
b. Banking law enacted in 1989 to be amended/regulated and continued to be implemented. In particular, adoption of prudential regulations to address: capital adequacy; lending and investment limits; loan classification; and reporting requirements.	c. Implementation of modern accounting and auditing standards (also for non-financial enterprises). d. **Action plans for medium-term** development and restructuring of individual banks.	
c. Adoption of modern accounting and auditing standards for all (financial and non-financial) **enterprises.**		
d. Agreement on framework and mechanisms for dealing with problem loans and recapita-lization of banks (in close connection with enterprise restructuring).		
3. Fiscal Policy a. **Satisfactory execution of 1990 budget, i.e., limit on budget deficit of about 1% of GDP for whole year and cut of total subsidies by about 50% as compared to 1989.**	3a. **Agreement on 1991 budget within adequate overall macroeconomic framework. Special focus on subsidies, social programs, and central government investment.**	3. Satisfactory execution of 1991 **budget and review of government investment** (level and priorities); enactment of tax legislation (VAT, income tax).
b. **Further cuts in coal, housing, transport and car subsidies (as compared to December 1989 draft budget for 1990), and reallocation of savings to social programs.**	b. Satisfactory progress in the **preparation of VAT and income tax (draft legislation to be reviewed).**	
c. **Understanding on 1990 central government investment.**		
4. Trade a. **Adherence to trade and exchange regime reformed as of 1/01/90.**	4. **Further review of trade regime for remaining quotas, subsidies, etc.**	4. **Adjustment of tariff structure to reduce dispersion.** Further **liberalization of current account transactions** (travel, **dividend transfers).**
Reform of Prices and Market Structures		
5. Maintain **free prices, except for energy, transportation, etc.**	5. Maintain **free prices.**	5. **Progress with CMEA reform** against options being explored with Bank assistance.
6. Adjust **energy, transport, etc., prices in real terms within 2-3 year adjustment horizon.**	6. Further **adjustment of energy prices according to plan to be agreed.**	

TABLE 5

SPECIFIC ACTIONS, TIMING, AND PROPOSED SAL CONDITIONALITY

Board Presentation/Effectiveness (Mid-1990)	**Second Tranche Release** (Early 1991)	**Beyond Second Trance** (Basis for future fast-disbursing lending; to be reflected in terms of broad intentions in the letter of development policy)
Reform of Prices and Market Structures (cont.)		
7. Adoption of demonopolization/ competition legislation and establishment of agency. Action program to phase out current procurement practices and action program to dismantle input distribution and output market monopolies in agriculture.	7. Satisfactory progress on procurement and agricultural marketing and input distribution.	
Enterprise Restructuring/Privatization/Private Sector Development		
8. Establishment of adequate legal framework for decentralized competitive, market-based system (enactment of legislation), including ownership question; deregulation/simplification of regulation to improve business environment; strengthening of (legislated) equality of treatment of social and private sector, eg., through equal access to credit; satisfac-tory implementation of foreign investment law enacted in 12/1988 and amended in 12/1989.	8. Satisfactory implementation of legal framework, as well as adoption of guidelines for divestiture/privatization.	8. Continued satisfactory implemen-tation of legal framework.
9. Establishment of adequate institutional framework for liquidation and restructuring (including privatization) of social enterprises as well as improved management of enterprises likely to remain in state sector.	9. Action plan for progressive implementation of strategy/ framework, including adherence to adequate environmental policy standards. Initiation of restructuring and privatization of X enterprises.	9. Satisfactory implementation of action plan.
Social Safety Net		
10. Enact/amend adequate system of unemployment benefits.	10. Satisfactory implementation of unemployment benefits and initiation of adequate program of social assistance in context of 1991 budget, based on sound social economic and financial principles.	10. Continued satisfactory progress in implementing social safety net.

82. Such a program would translate into Bank commitments on the order of about $2.5 billion for FY90-92 and disbursements growing from about $300m in calendar 1990 to about $800 million per year in 2-3 years. The Bank's exposure would increase to the equivalent of about 10 percent of total external debt (strongly influenced by expected debt/debt-service reduction), with debt service obligations to the Bank absorbing about 1.8 percent of total convertible currency export earnings. However, Poland's current creditors would remain its main financing sources through large-scale reschedulings, some new flows, and exceptional interest relief (or equivalent measures).

83. The Bank's proposed program is predicated on satisfactory progress in implementing the stabilization and adjustment program and of regularizing relations with current creditors. The stabilization process has been launched, with the strong support of the IMF through the Standby arrangement, which is expected to be followed by an EFF arrangement (possibly on the order of up to 100 percent of quota per year, equivalent to $725m) over a three-year period. Relations with other creditors are as follows:

(a) Paris Club. The Paris Club accounts for about two thirds of total debt. After several reschedulings (the most recent one in 1987 which, however, has never been implemented) Poland's debt-service obligations to Paris Club creditors currently amount to about $3.3 billion p.a., of which about $700 million (mostly interest) are in arrears. Relations with Paris Club members have improved, in spite of the arrears, with high level political support and continued tolerance of Poland's inability to make debt-service payments. Paris Club governments would be expected to reschedule all principal payments falling due for at least the next three years and provide exceptional relief on interest payments--or equivalent measures (which most likely would have to be handled on a bilateral rather than multilateral basis). The next rescheduling agreement is expected in February 1990 following approval of the IMF standby arrangement. Several bilateral creditors have already announced programs to reintroduce export credit cover for lending to Poland (e.g., FRG, France, Italy) as well as significant programs of bilateral aid (food, technical assistance and program aid); their actual implementation depends in some cases on approval of the IMF Standby and/or formal bilateral reschedulings being completed.

(b) London Club. Commercial bank debt is about one-fourth of total debt and debt service obligations, also after several reschedulings, are about $900 million per year (slightly less than 10 percent of convertible currency earnings). Relations with commercial banks have deteriorated somewhat, as Poland told the banks that repayment of principal would be deferred and that it wished to avail itself of the treatment offered to other countries under the Brady Plan. Some type of debt service reduction scheme will have to be ultimately negotiated as part of an overall effort, to become effective possibly only in 1991. New money would also be needed and could be mobilized through cofinancing with the Bank, but probably only with official guarantees or, at a minimum, revised prudential regulations regarding exposure to Poland (as current provision requirements amount to 50 percent of any increase in MLT exposure to Poland).

(c) Western Bilaterals. New bilateral support (other than food aid) has so far been slow to materialize, in part pending clarification of the Government's program and effective coordination of potential assistance by the Polish authorities, but also because of the donors' budgetary constraints. The G-7 have designated the European Community (EC) to take the lead in coordinating bilateral support for Poland (and Hungary).

(d) USSR. The Soviet Union generally has been supportive of the political and economic reforms, albeit within the boundaries of safeguarding Warsaw Pact obligations, and rescheduled about half of Poland's $3.26 billion hard currency debt. More may need to be done in the future, and Poland has explained that it expects to obtain from the USSR treatment equivalent to that of the Paris Club.

84. In addition to current creditors, several other groups are becoming important. The G7 requested the EC to take a leading role in coordinating bilateral assistance to Poland and Hungary, starting with the emergency food aid launched last autumn. Since that time, the EC has held a number of coordination meetings including members of the G24 and is working via special task forces on specific areas--e.g., food, environment, training, industrial restructuring, and trade relations. The EC itself announced a $200 million grant for Poland this year, and the EIB was authorized to lend about ECU 1 billion to Poland over the next three years (under a 100 percent guarantee from the EC budget). Complementing this strong support from established European institutions, the G24 agreed to establish a new bank for lending to all of Eastern Europe, in which Europeans would take the majority of shares, called the European Bank for Reconstruction and Development (EBRD). The EBRD is expected to be operational by the end of 1990.

85. The strategy of Bank assistance to Poland is being closely geared to the development and implementation of the Polish reform program. Through the development of policies and institutions to implement the reforms, we expect to help identify and thereafter partially finance investments needed to restructure the productive base. In this way we help insure that the policy environment is conducive to making optimal investment decisions. We also anticipate using our proposed lending to help bring in significant potential cofinancing from official and commercial sources. By diversifying the sources of new lending, we share the risks of new flows, and also help to ensure that those potential funds are directed appropriately. We conceive of the scale and pace of Bank lending as self-regulating: the faster the reforms, the greater the scope for overall lending; the more cofinancing we can bring along, the lower the financial risk to the Bank.

VI. Next Steps

86. After OC review, the appraisal mission would visit Poland in the second half of February. Negotiations could be held in early May. Loan

processing follows an accelerated schedule, with major risks and possibilities of slippage involved, mainly due to uncertainties in Poland regarding proposed policies and the implementation of policies agreed with the IMF.

UThumm:mes
2/2/90

POLAND - ELEMENTS OF STRUCTUAL ADJUSTMENT PROGRAM

(Broad and more comprehensive framework to be reflected in the letter of development policy.
For timing of more specific measures and specific SAL and conditionality see Chapter IV

Objectives	Areas of Intervention	Actions Already Taken	Program
I. Macroeconomic Program (and related micro reforms)			
1. Medium-Term Framework and Financing Plan	- Add medium-term perspective to financial program supported by Fund SBA.	- Comprehensive macroeconomic stabilization and liberalization program implemented as of 1/01/90 and supported by Fund SBA.	- Medium-term perspective of macroeconomic adjustment conducive to restored growth, and progressively restored creditworthiness, with special emphasis on the links between microeconomic/structural measures and overall framework and the additional financial requirements stemming from the enterprise and financial sectors, social programs, and higher government investment in priority areas.
			- Agreement on key variables (such as interest and exchange rates, fiscal deficit [including adequate level and structure of expenditures] as well as inflation and current account of the balance of payments) to be monitored during SAL implementation and beyond (keeping the evolving nature of the framework in mind).
			- External financing plan including debt more effective debt management and creditors. Efforts towards more effective debt management and better aid coordination.
2. Monetary Policy/Financial Sector Reform	- Interest and exchange rate policy	- Major adjustments made in context of SBA supported stabilization program	- Maintenance of "reasonable" level and structure of interest rates (to make zloty instruments attractive and ensure efficient use of resources). Agreement on interest rates to cover all operations regardless of source of funding.
	- Strengthen institutional framework at NBP for macro-management.	- Change in constitution limiting NBP credit to Government.	- Initiate audits of individual banks (in the context of Bank supported agroindustrial and export development projects).
		- Establishment of 2 tier banking (NBP, reformed as central bank, and divestiture of its commercial loan portfolio to independent commercial banks).	- Develop prudential regulations for decentralized competitive banking system (TA program to be mounted independently with support from Bank and others).
			- Program to phase out interest subsidies for special purpose loans (e.g., agriculture, housing), incl. transparent funding during the transition phase by centr. govt. thru the budget.

POLAND - ELEMENTS OF STRUCTUAL ADJUSTMENT PROGRAM

(Broad Framework)

Objectives	Areas of Intervention	Actions Already Taken	Program
2. Monetary Policy/Financial Reform (cont.)	- Strengthen further the role of the financial sector.	-	- Develop adequate schemes for financing of housing and agriculture (based on lower/no subsidies). - Development of adequate accounting and auditing standards for all (financial and non-financial) enterprises. - Establish framework for dealing with problem loans and ultimately restructuring of financial institutions (including possible privatization) which will accompany enterprise restructuring and bankruptcy procedures. - Regulation on collateral, non-performing assets, provisioning, and bankruptcy. - Development of money market and instruments for open market operations. - Establish framework/action plan for development of non-bank financial sector (pension funds, insurance, money and capital markets, etc.). - Promote competition among banks by expanding branch networks and licensing of new banks (including foreign banks/joint ventures).
3. Fiscal Policy (including government investment)	- Improve budgetary transparency and procedures to identify costs for production/consumption subsidies and restructuring of social enterprises.	- 1990 budget with greatly reduced subsidies (cut by about 50% as compared to 1989), and with an overall deficit equivalent to slightly less than 1% of GDP.	- Further progress in budgeting techniques (based on technical assistance being provided by the IMF). - Understanding on level and structure of subsidies and central government investment. - Further reduction of off-budget expenditures and subsidies, to be reflected in 1991 budget.

POLAND - ELEMENTS OF STRUCTUAL ADJUSTMENT PROGRAM

(Broad Framework)

Objectives	Areas of Intervention	Actions Already Taken	Program
3. Fiscal Policy (cont.)		-	- Economic evaluation of all investment support to enterprises and Central Government investment projects (based on method to be adopted); reflection in 1991 budget.
	-Simplify and strengthen tax system.		- Preparation of VAT and personal income tax.
	- Define government responsibility for debt/external assistance management.		- Establish policy for current and future debt incurred.
			- Program to coordinate foreign assistance flows.
4. Foreign Trade/Balance of Payments	- Exchange rate management	- Devaluation and unification of exchange rate (as of 1/01/90)	- Maintain competitive exchange rate.
	- Import trade regime	- Establish exchange market through banking system	- Expand current account liberalization (to cover all dividend transfers and travel).
			- Review tariff structure in light of new exchange system.
	- Export subsidies and taxes	- Elimination of subsidies (as of 1/01/90)	- If warranted, adopt generally applicable export promotion measures (e.g. tax drawback scheme; strengthening of export marketing services).
	- Reduce scope of centrally balanced commodities and centrally financed imports (CMEA trade)		- Clarify scope/impact by sector/commodity of CMEA regime and establish program to phase out over time.

POLAND - ELEMENTS OF STRUCTUAL ADJUSTMENT PROGRAM

(Broad Framework)

Objectives	Areas of Intervention	Actions Already Taken	Program
II. Reform of Prices and Market Structures	- Reform price information	- Elimination of price controls as of 1/01/90, except for energy, transportation, and some other items amounting to the equivalent of about 10% of GDP (5% of wholesale and retail sales).	- Further price liberalization.
		- Major adjustment of energy, transport prices as of 01/01/90.	- Further program for adjustment of controlled prices, particularly energy and transport (within agreed 2-3 year adjustment horizon and linked to reduction of subsidies).
	- Dismantle monopolistic structure of business associations		- Program to evaluate current procurement practices and establish program for phase-out over time
	- Reduce scope of centrally contracted procurement (Government orders).		
	- Demonopolization		- Action program to dismantle input distribution and output market monopolies in agriculture.
			- Action program to dismantle multiplant and vertically integrated enterprises, whenever feasible
III. Enterprise Restructuring/Privatization/Private Sector Development	- Regulatory framework	- Equality of treatment of private and public sectors	- Establish legal framework for decentralized, competitive market-based system (with mixed ownership agents)
		- New foreign investment law enacted 12/88 and amended 12/89	
	- Social enterprise strategy		- Establish guidelines for financial workouts for bankruptcy
			- Establish adequate institutional framework for liquidation and restructuring (including privatization) of social enterprises as well as improved management for enterprises likely to remain in state sector, subject to adherence to adequate environmental standards (see V.)
	- Privatization/ownership		- Clarify ownership question through adequate legislation
			- Establish guidelines for divestiture/privatization
			- Adopt adequate enterprise acctg. and auditing standards (see also financial sector)

POLAND - ELEMENTS OF STRUCTUAL ADJUSTMENT PROGRAM

(Broad Framework)

Objectives	Areas of Intervention	Actions Already Taken	Program
IV. Social Dimension	- Improve social planning apparatus		- Upgrade data base for social policy decision-making process (e.g., targeting of subsidies)
	- Establish social safety net		- Establish well-targeted subsidies - Establish adequate unemployment benefit scheme - Establish adequate social assistance scheme with linkages to private agencies to channel domestic and foreign assistance - Establish employment information/ placement system - Establish training/retraining programs for displaced workers - Divest social services from state-owned enterprises - Reorganize institution(s) with broad delivery systems catering to the general public
V. Environment	- In connection with enterprise reform/restructuring, adoption of more effective environmental policies		- Review the current system of fees and fines, and adoption of a revised system - Adoption of revised standards/permits, region by region - Adoption of enforceable negotiation process for phased implementation of revised standards in existing enterprises - Elimination of proposed tax holidays for environmental investments

Poland - ECONOMIC INDICATORS

Mid-1987 Population (mils.) 37.8
1988 Per Capita GNP in US$: 1,864.0

	A. Shares of Gross Domestic Product (from current price data)						B. Growth Rates (% per annum) (from constant price data)				
	1965	1975	1980	1986	1987	1988	1965-73	1973-80	1980-84	1987	1988
Gross Domestic Product m.p.		100.00	100.00	100.00	100.00	100.00			-1.1	2.0	4.1
Net Indirect Taxes											
Agriculture		14.98	15.95	15.40	13.20	14.20				-7.8	1.3
Industry		69.57	62.34	60.20	61.50	60.90				3.0	5.1
(of which Manufacturing)		..	..	..	..	..					
Services		15.45	22.00	24.40	25.30	24.90				5.7	6.2
Resource Balance			-3.00	1.40	2.40	2.80					
Exports of GNFS			28.10	18.20	21.40	22.80			1.5	5.0	9.4
Imports of GNFS			31.10	16.80	19.00	20.00			-5.3	4.6	9.8
Total Domestic Expenditures			102.40	99.00	97.20	97.30			-2.2	1.7	4.1
Total Consumption			76.10	69.70	68.30	64.70			-0.7	2.3	2.5
Private Consumption			66.90	60.60	59.90	56.50			-1.9	2.5	2.9
General Government			9.20	9.10	8.40	8.20			2.0	1.0	0.0
Gross Domestic Investment			26.30	28.90	28.90	32.60			-4.2	2.9	9.5
Fixed Investment			24.70	21.90	22.60	22.50			-4.4	4.1	6.1
Changes in Stocks			1.60	7.00	6.30	10.10				-0.8	20.7
Gross Domestic Saving			23.40	30.30	31.70	35.30			..	..	..
Net Factor Income (accrual basis)				-3.47	-4.49						
Net Current Transfers				1.28	2.25						
Gross National Saving				28.11	29.46						

In billions of Zlotys (at constant 1982 prices)	1965	1973	1980	1986	1987	1988
Gross Domestic Product			6267.80	6471.30	6600.73	6871.36
Capacity to Import			1253.27			
Terms of Trade Adjustment			12.17			
Gross Domestic Income			6280.00			
Gross National Product						
Gross National Income						

C. Price Indices	(1980 = 100)						Inflation Rates (% p.a.)				
	1980	1984	1985	1986	1987	1988	1965-73	1973-80	1980-87	1987	1988
Consumer Prices (IFS 64)	100.00	352.20	403.50	474.92	594.60	922.90			26.0	25.2	60.0
Wholesale Prices (IFS 63)	100.00	320.50	372.40	372.40	463.27	759.76			24.5	24.4	64.0
Implicit GDP Deflator	100.00	357.17	415.70	491.40	618.7	996.73			29.7	28.7	61.1
Implicit Expenditures Deflator	100.00	360.39									

D. Other Indicators:	1965-73	1973-80	1985-87	1988
Growth Rates (% p.a.):				
Population		0.9	0.6	0.03
Labor Force			-0.2	-1.00
Gross Nat'l. Income p.c.			3.7	4.10
Private Consumption p.c.			3.1	1.70
Import Elasticity:				
Imports (G+NFS) / GDP(mp)			1.5	
Marginal Savings Rates:				
Gross National Saving				
Gross Domestic Saving				
ICOR (period average): a/			4.6	

a/ Period 1982-85.

Share of Total Labor Force in:	1965	1973	1980	1987	1988
Agriculture			29.7	28.2	27.6
Industry			38.0	34.9	34.8
Services			32.3	36.9	37.6
Total			100.0	100.0	100.0

Notes:
Unallocated items added to private consumption.
GDP by source data from Net Material Product data. Data for 1975 used instead of 1973.
Industry includes construction.
Labor force refers to total employment.

Poland - ECONOMIC INDICATORS

E. Merchandise Exports	Volume Index (1980=100): 1980	1984	1985	1986	1987	1988	Value at Current Prices (million US$): 1980	1984	1985	1986	1987	1988
Fuel & Elec Energy							2409.7	2059.8	1801.2	1594.0		
Raw Materials							856.0	767.3	822.1	789.0		
Capital Goods							4715.0	4542.4	4530.1	4693.0		
Manuf Consumer Goods							5068.3	3426.6	3371.6	3927.0		
Foods, Raw & Processed							1142.4	953.7	964.4	1066.0		
Total - Exports	100.0	106.3	107.7	113.0	118.4	129.5	14191.4	11749.8	11489.4	12069.0	11602.0	13211.0
F. Merchandise Imports												
Fuel & Elec Energy							3112.6	2479.0	2416.9	2330.3		
Raw Materials							1742.2	1175.1	1148.8	924.6		
Capital Goods							4227.0	2974.0	3336.4	3649.8		
Manuf Consumer Goods							4627.0	3068.8	3096.4	3366.2		
Foods, Raw & Processed							2981.0	1288.3	1186.2	1264.6		
Total - Imports	100.0	81.9	88.4	92.7	96.9	105.3	16689.8	10985.2	11184.7	11535.5	10803.0	12064.0

G. Terms of Trade (1980=100)	1980	1984	1985	1986	1987	1988
Merch. Exports Price Index	100.0	198.5	248.1	296.0	432.2	731.9
Merch. Imports Price Index	100.0	212.4	259.2	303.5	427.3	689.8
Merchandise Terms of Trade	100.0	93.5	95.7	97.5	101.1	106.1

Notes: Data above and in the first six columns combine convertible and nonconvertible currencies.

Trade data do not match BOP trade information due to timing and valuation differences.

H. Balance of Payments 1/	1980	1984	1985	1986	1987	1988	Convertible Currency Balance of Payments US$ millions (at current prices): 1980	1984	1985	1986	1987	1988
Exports of Goods & NFS	15655.0	12835.0	11976.0	12730.0	12864.0	14576.0	8284.0	5857.0	5677.0	5912.0	6880.0	7974.0
Merchandise (FOB)	14170.0	11800.0	10882.0	11558.0	11602.0	13211.0	7364.0	5324.0	5120.0	5316.0	6163.0	7248.0
Non-Factor Services	1485.0	1035.0	1094.0	1172.0	1262.0	1365.0	920.0	533.0	557.0	596.0	717.0	726.0
Imports of Goods & NFS	17254.0	11943.0	11366.0	11961.0	11940.0	13357.0	9190.0	4544.0	4615.0	4964,0	5891.0	7132.0
Merchandise (FOB)	15806.0	10962.0	10436.0	10914.0	10803.0	12064.0	8154.0	3944.0	4032.0	4281.0	5123.0	6307.0
Non-Factor Services	1448.0	981.0	930.0	1047.0	1137.0	1293.0	1036.0	600.0	583.0	683.0	768.0	825.0
Resource Balance	-1599.0	892.0	610.0	769.0	924.0	1219.0	-906.0	1313.0	1062.0	948.0	989.0	842.0
Net Factor Income	-2357.0	-2638.0	-2554.0	-2663.0	-2915.0	-2955.0	-2333.0	-2549.0	-2444.0	-2557.0	-2815.0	-2855.0
(interest payment due)	2496.0	2833.0	2730.0	2851.0	3132.0	3226.0	2463.0	2729.0	2609.0	2734.0	3012.0	3092.0
Net Current Transfers	656.0	467.0	768.0	946.0	1413.0	1434.0	653.0	462.0	764.0	944.0	1409.0	1433.0
(private transfers)	523.0	462.0	764.0	944.0	1409.0	1434.0	523.0	462.0	764.0	944.0	1409.0	1433.0
Current Account Balance	-3300.0	-1279.0	-1176.0	-948.0	-578.0	-302.0	-2586.0	-774.0	-618.0	-665.0	-417.0	-580.0
M & LT Capital Inflow	2659.0	-2651.0	-2070.0	-3218.0	-3125.0	-3817.0	2858.0	-2584.0	-2142.0	-3394.0	-3202.0	-3541.0
Actual Loan Drawings	8840.0	627.0	723.0	1112.0	659.0	341.0	8669.0	218.0	261.0	294.0	317.0	259.0
Repayments	5971.0	3136.0	2816.0	4103.0	3552.0	4036.0	5605.0	2719.0	2417.0	3472.0	3241.0	3694.0
Due & Paid	5971.0	781.0	1164.0	1346.0	957.0	978.0	5605.0	364.0	765.0	715.0	646.0	636.0
Due & Unpaid	..	2355.0	1652.0	2757.0	2595.0	3058.0	..	2355.0	1652.0	2757.0	2595.0	3058.0
Rescheduled	..	740.0	1576.0	1457.0	2283.0	2943.0	..	740.0	1576.0	1457.0	2283.0	2943.0
Not Rescheduled	..	1615.0	76.0	1300.0	312.0	115.0	..	1615.0	76.0	1300.0	312.0	115.0
Other M & LT Capital	-210.0	-142.0	23.0	-227.0	-232.0	-122.0	-206.0	-83.0	14.0	-216.0	-278.0	-124.0
S-T Capital & Errors	239.0	431.0	568.0	-260.0	79.0	-331.0	-674.0	-141.0	82.0	-367.0	-5.0	-312.0
Change in Reserves	402.0	-340.0	236.0	173.0	-797.0	-561.0	402.0	-340:0	236.0	173.0	-797.0	-561.0
Rescheduled Obligations	..	2427.0	13337.0	1688.0	7484.0	4700.0	..	2427.0	13337.0	1688.0	7484.0	4700.0
Changes in Arrears	..	1412.0	-10895	2565.0	-3063.0	354.0	..	1412.0	-10895	2565.0	-3063.0	354.0
Interest	..	1017.0	-3263.0	1483.0	-2102.0	583.0	..	1017.0	-3263.0	1483.0	-2102.0	583.0
Principal	..	395.0	-7632.0	1082.0	-961.0	-229.0	..	395.0	-7632.0	1082.0	-961.0	-229.0
As shares of GDP:												
Resource Balance	-2.82	1.18	0.86	1.04	1.47	1.87	-1.60	1.73	1.50	1.29	1.58	1.30
Interest Payments (accrual)	4.40	3.74	3.85	3.87	5.00	4.96	4.34	3.60	3.68	3.71	4.80	4.75
Current Account Balance	-5.82	-1.69	-1.66	-1.29	-0.92	-0.46	-4.56	-1.02	-0.87	-0.90	-0.67	-0.89

Memorandum Items:	1980	1984	1985	1986	1987	1988
Int'l. Reserves (mil. US$)	..	1106	870	698	1495	2056
Reserves incl. Gold (mil.US$)	..	1252	1024	883	1684	2245
Official X-Rate (Zl/US$)	44.22	113.24	147.14	175.29	265.08	430.6
Index Real Eff. X-R 1980=100 2/	100.0	147.3	130.4	103.3	72.7	67.8
GDP (Millions of current US$)	56712	75732	70986	73740	62700	65100

1/ Transactions within swing limits under bilateral payments together with related capital account transactions are included in nonconvertible BOP.

2/ Decline implies depreciation.

p = preliminary data. e = estimate.

Poland - ECONOMIC INDICATORS

I. Budget (State)	Shares of GDP (%) 1980	1984	1985	1986	1987	1988	Growth Rates (% p.a.) 1980-83	1986	1987	1988
Tax Receipts	38.96	36.51	37.00	37.49	31.47	33.37	37.0	25.6	9.8	85.5
Other Receipts	9.38	3.17	3.44	2.43	4.94	2.21	-6.5	-12.2	165.2	-21.7
Current Expenditures	45.33	36.65	35.94	35.17	32.15	30.48	29.4	21.3	19.5	65.3
Current Budget Balance	3.01	3.03	4.50	4.75	4.26	5.11	..	..	..	..
Capital Expenditures	4.17	5.27	5.66	5.86	5.56	5.33	54.0	28.5	24.9	67.6
Overall Balance	-1.15	-2.24	-1.16	-1.11	-1.30	-0.22	..	..	..	..
External Borrowing (net)			0.44	0.68	0.11	-0.33				
Domestic Non-Bank Financing			..	..	..	..				
Domestic Bank Financing			-0.49	-0.37	0.71	0.00				
Extrabudgetary Funds			1.21	0.80	0.48	0.55				

J. External Capital Flows, Debt and Debt Burden Ratios	Net Disbursements (US$ Millions) 1980	1984	1985	1986	1987	1988	Debt Outstanding & Disbursed (US$ Bln) 1980	1984	1985	1986	1987	1988
							Includes Interest Arrears & Non-Guaranteed Debt					
Public & Publicly Guar. LT							22.7	20.3	23.5	26.3	29.8	30.7
Official Creditors												
Multilateral												
of which IBRD												
of which IDA												
Bilateral												
Private Creditors												
Export credits (net)		-85	13	-211	-280	-106						
Financial Markets												
Private Non-Guaranteed LT								7.5	8.2	9.9	10.8	10.0
Total LT Disbursements	8669	218	261	294	317	259						
IMF Net Credit	..	..	..	..	..		..	..	..	..	..	..
Net Short-Term Capital	144	588	637	248	175		2.8	1.9	1.4	1.5	1.5	1.4
Total incl. IMF & Net ST							25.5	29.7	33.1	37.7	42.1	42.1

Bank and IDA Ratios	1980	1984	1985	1986	1987	1988
Share of Total Long-Term DOD						
1. IBRD as % of Total	..	..	..	..	..	..
2. IDA as % of Total	..	..	..	..	..	..
3. IBRD+IDA as % of Total	..	..	..	..	..	..
Share of Total LT Debt Service						
1. IBRD as % of Total	..	..	..	..	..	..
2. IDA as % of Total	..	..	..	..	..	..
3. IBRD+IDA as % of Total	..	..	..	..	..	..

Notes: Data above and in first six columns refer to combined convertible and nonconvertible currencies.
Interest arrears are included in M & LT convertible currency debt.

DOD-to-Exports Ratios (%)	1980	1984	1985	1986	1987	Convertible Currency Debt Ratios 1980	1984	1985	1986	1987	1988
1. Long-Term Debt/Exports	143.7	213.4	260.9	280.2	310.4	262.7	424.1	484.4	527.2	532.7	
2. IMF Credit/Exports	..	..	..	..	..	..	..	..	..		
3. Short-Term Debt/Exports	17.7	14.6	11.5	11.6	11.5	23.8	21.5	24.0	23.0	21.2	
4. LT+IMF+ST DOD/Exports	161.5	227.9	272.4	291.8	321.8	286.5	445.6	508.4	550.2	553.9	

DOD-to-GDP Ratios (%) Convertible Currency	1980	1984	1985	1986	1987
1. Long-Term Debt/GDP	40.0	36.7	44.7	49.1	64.8
2. IMF Credit/GDP	..	..	..	..	..
3. Short-Term Debt/GDP	4.9	2.5	2.0	2.0	2.4
4. LT+IMF+ST DOD/GDP	45.0	39.2	46.6	51.1	67.1

Debt Service Due Ratios (DS/Exp) in % in Convertible Currency	1980	1984	1985	1986	1987
1. Public & Guaranteed LT					
2. Private Non-Guaranteed LT					
3. Total LT Debt Service	95.9	90.2	86.0	101.9	88.4
4. IMF Repurchases+Serv.Chgs.	..	..	..	..	..
5. Interest Only on ST Debt					
6. Total (LT+IMF+ST Int.)					

③ ~~JWS~~
② ~~AMH~~
① ~~BBC~~

TRANSCRIPT OF PROCEEDINGS

WORLD BANK

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PRESS CONFERENCE

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MR. BARBER CONABLE, PRESIDENT

ON

POLISH LOANS

* * *

Pages 1 thru 28

Washington, D. C.
February 6, 1990

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WORLD BANK

PRESS CONFERENCE

- - -

MR. BARBER CONABLE, President

on

POLISH LOANS

Tuesday, February 6, 1990
4:05 p.m.

E1244 Conference Room
701 19th Street, NW
Washington, D.C.

MILLER REPORTING CO., INC.
507 C Street, N.E.
Washington, D.C. 20002
(202) 546-6666

PROCEEDINGS

MR. AGUIRRE-SACASA: Let me introduce myself very quickly. My name, for those of you who don't know me, is Francisco Aguirre-Sacasa; I'm the Director of External Affairs here at the Bank.

I would like to welcome you all to this press conference on the recent approval of Bank Poland loans, and also to apologize to you for having shifted the time of this press conference. We didn't want to hold it until our Executive Board had concluded its deliberations on these two important loans.

Before turning the press conference over to Mr. Conable, who has some brief introductory remarks, I'd like to handle two or three housekeeping matters quickly.

First of all, there is a press release outside that is available for all of you, for immediate use, and Mr. Conable's opening remarks are also available outside, for those of you who are interested, after the press conference.

The press conference today will be on the record. All that is said is for immediate use, and we would appreciate it, when you ask your questions, if you could identify yourselves and the newspapers or media that you are affiliated with.

Finally, I'd like to introduce very quickly to you the three Bank spokesmen who are here. One, as you know very well, is Mr. Barber Conable, President of the Bank. To his immediate right is Mr. Woody Wapenhans, who is the Senior Vice President for the Europe, Middle-East and North Africa region of the Bank. Mr. Wapenhans is a German national.

Next to him is Mr. Eugenio Lari, from Italy, who is the Director of the Eastern Europe Department of the Bank; and they will be the ones who will be addressing your questions.

Thank you very much, and without further ado I'll turn it over to you, Mr. Conable.

MR. CONABLE: Thank you very much for coming. Moments ago--as a matter of fact, we completed the meeting at 3:35, to give you some idea of what a tight schedule we're operating--our Board of Executive Directors approved two loans totalling $360 million to Poland.

These are our first loans to Poland since it rejoined the Bank some two years ago. The first loan, for $260 million, will support an Industrial Export Development Project. The other, for $100 million, will help finance an Agroindustries Export Development project. These will develop important foreign exchange credits for Poland.

Over the past three and a half years, Bank staff have been working closely with Polish authorities. We anticipated their membership in the Bank and during the period of time before they were represented on our Board, but were members, we were already setting their economic and sector problems.

The aim of the dialogue we've been having has been to help that country improve living conditions for its citizens by rendering its economy more efficient, and by more fully integrating it into the world economy. These contacts have gained momentum and become more fruitful since late last summer, when the current administration came to power and accelerated the process of economic reform and stabilization.

The record of the current government has been impressive. It has boldly begun to deal with the severe distortions which hamper the economy, and has started to introduce major systemic changes which Poland needs. More specifically, the government has introduced tough fiscal and monetary measures to rein in inflation, which ran as high as 50 percent per month late in 1989.

It has concurrently taken far reaching action to liberalize the economy. Most prices have been freed, the exchange rate has been unified at a realistic level, unsustainable subsidies have been cut by more than half, the process of freeing interest rates is well under way, and finally, state intervention in the financial and enterprise sectors has been greatly reduced.

While the process of economic transformation has just begun, and will be a lengthy one, these actions constitute a courageous break with the past, and deserve broad international support.

The Bank intends to be a close partner in this process. The loans our Board approved this morning, and this afternoon, will help to generate much needed foreign exchange for the economy by triggering greater output in the industry and agroindustries sectors.

The sectors already account for over half of Poland's exports to hard currency markets, and offer the greatest potential for quick further growth in exports. The projects will also result in the production of meat and more and better quality industrial and agroindustrial goods for the local population. Finally, it will help support a strengthening of Poland's banking system.

Looking to the future, the Bank is working with Poland on a lending program which could reach--depending upon performance--$2.5 billion in new commitments over a three-year period. This program will focus on supporting further policy reforms--including measures aimed at promoting a greater reliance on market forces and the private sector.

It will also focus on continued institutional improvements, on financing key investments in infrastructure and on tackling environmental pollution, which, as you know, is a very serious problem in Poland.

Moreover, Bank lending to Poland will help the government provide its citizens with an adequate "safety-net" in order to help ease the social costs inherent in the process of economic transformation.

Others will have to assist Poland, too. Indeed, nothing short of a broad-based international effort is warranted, given Poland's proven commitment to reform and courageous actions to date. In this regard, I'd like to express my great pleasure with the IMF's approval yesterday of a Standby to Poland, and am encouraged by the bilateral and multilateral support which the countries of Western Europe and Japan are mounting.

Because of Poland's heavy indebtedness, I also look forward to action by the London and Paris Clubs to help ease Poland's debt service burden.

These issues, or anything relating to our two loans, I'm happy to take up with you now.

MR. NORMAN: On the further $2.5 billion in lending to Poland over the next three years, how soon might you crank some real dough out in the second half of this year?

MR. CONABLE: We have the potential, if there is progress in the economy, of a substantial adjustment loan sometime around the beginning of the next fiscal year, which would be June or July of this year.

We are expecting, as I said, $2.5 billion, if things develop as we hope they will, over a three-year period; and so you can see a significant lending program somewhere short of a billion dollars is possible on an annual basis.

MR. AGUIRRE-SACASA: Ms. Kaps?

MS. KAPS: Mr. Conable, yesterday there was a press release on the IMF loan, and the Bank was mentioned explicitly in the section on the social impact section, that the Bank would probably go into helping the Polish government somehow--how could I say that? Decrease the social impact of the lowest percentage of the population.

What kind of specific project had the IMF in mind, that the Bank be helping?

MR. CONABLE: I can't speak for the IMF, but obviously we're concerned about an adjustment program there, and an austerity program, on top of the deterioration of living conditions in Poland, which has already occurred, which could result from, for instance, the layoff of employees from parastatial activities of various sorts.

The unemployment rate will be a serious concern there, and of course, in Poland's previous--the system that previously operated, there was no need for a social or safety net of any sort, because they maintained full employment in one way or another. That is one of the difficulties they've had.

We expect them to be working in various social areas to try to ease any possible hardship that results from this type of an adjustment program.

MR. AGUIRRE-SACASA: Mr. Woods?

MR. WOODS: Mr. Conable, what do you and your staff regard as the most formidable difficulties in transforming a centrally planned economy to a free market economy? That the Poles are encountering?

MR. CONABLE: Well, I'll ask the staff some of the technical problems that face them. Of course, in Poland's case you have an economy which has not had any market forces functioning in it, except informally, and thus you have to do a complete transformation. You don't have anything on which to build.

And, in such an environment, it is very difficult to establish an appropriate sequence of change. It's very difficult to bring about all the changes necessary all at once, and if the sequence is not correct, or the timing is not correct, serious distortions can occur in an economy which is already resting quite heavily on the citizens of the country.

So, there is a problem of timing and sequence which is probably the most difficult to work with.

Now, we have a lot of experience in moving from nonmarket type economies to market type bank economies; but usually we have something on which to build--we had at least an element of mix in the economy, which is not the case here.

Now, what would you like to say, Mr. Wapenhans?

Mr. Wapenhans is our Vice President in charge of the region, very experienced in such matter, and we're grateful to have his advice, but let him answer that question the way he sees it.

MR. WAPENHANS: Very little to add, Mr. Conable. I think the first important step, and a very critical step, is to make the stabilization stick, so that we can reestablish that degree of confidence that is necessary to begin the process of a market economy.

But the market forces, of course, are dependent on market mechanisms, and that means putting in place the necessary institutions, and putting them in place at a pace and with a management of the transition that prevents an unnecessary decline in the output, and provokes, at the same time, the sufficient supply response that, in turn, supports the stabilization effort.

I think these are the two critical questions in the medium term.

MR. CONABLE: Expressed in another way, there's a big expectancy among the people of Poland, and, of course, we have to move with all dispatch, as does the government, in order to meet that expectancy, in order to avoid disillusionment and the various negative things that follow from a failure to move with considerable speed and efficiency, and in the proper sequence.

MR. McNAMEE: Could we talk about the environmental aspect of these loans, and your future projects? I understand you have a technical assistance component coming up that would be, what, to build up their environmental regulation--regulatory structure--or what?

MR. CONABLE: Poland has one of the most serious environmental problems in Europe at this point, and these loans will not affect the environment significantly. However, we have some follow-on expectations in that respect.

Mr. Lari, could you tell us something about where you think the environmental effort will focus primarily?

MR. LARI: I think initially--and we hope to grant a loan in the next two to three months--is to build the institutions and the regulations to help the Polish authorities to absorb a very substantial amount of technical assistance, and financial assistance, which will be needed to start addressing the environmental programs.

MR. CONABLE: They simply don't have the structure that they need at this point.

MR. LARI: They don't have the structure, both centrally and locally, and the programs are going to be flabbergasting, then, for the amounts. We calculate that if they were to make a serious dent in the air and water and land pollution, they should invest something like $25 billion over the next ten years, for which $12.5 million alone would be for retrofitting existing power plants with modern, pollution-control equipment, and this is just to give you that benefit.

So I think it is urgent to provide a much better absorptive capacity, and the capacity for the inclusion of these programs.

MR. CONABLE: Let me further specify here. They have a serious problem in the energy area, where they are expending--in fact, wasting--a good deal of energy, and the result is, they're getting something like six times as much pollution per unit of work delivered as is common in the West.

Now, it is a large country, but it also has neighbors, and obviously this expenditure of energy, if it goes beyond what is necessary, is creating a generalized regional pollution problem.

MS. MORRIS: Could I just follow up on that? Is this not a systemic problem in the East Bloc generally?

MR. CONABLE: Yes, it is.

MS. MORRIS: And so therefore--I mean, one cannot get into the business of just isolating.

MR. CONABLE: No.

MS. MORRIS: I presume that the Bank has a program which is going to affect other nations, and perhaps you can elaborate a bit on that.

MR. CONABLE: Well, obviously we are talking about Poland here today. Many of the programs that will be developed for other countries depend on their membership, depend on their priorities, and depend on what we can learn in Poland, as well.

Clearly, it is a regional problem. As a matter of fact, the Russians will tell you there's a regional problem, because they lie to leeward to all these Eastern European countries.

However, I would prefer not to generalize too much about the common nature of the problems in Eastern Europe for this reason. I, this past week, have been at the World Economic Reform conference in Davos, and all the Eastern European governments were represented there, usually on the highest level. It was quite interesting to see the leaders of these Eastern European countries, some of them only recently ensolved(?), come to talk with Western businessmen and Western leaders at this forum.

And one thing that struck me was how each of them considered his own position to be unique, in his own country, to have this special problem. In other words, what we have been saying here at the Bank for years, that all problems are country by country, and must be dealt with on a country by country basis, applies to Eastern Europe as well.

Now, you're absolutely right that in most of

Eastern Europe there is a very severe environmental problem, because that has not been high on their list of priorities, and so there is some community of effort necessary there. Clearly, in the long run, it will have to be dealt with, however, in each country according to its own priorities and according to its own needs.

Now, these different countries have different industrial. Some of them are more heavily reliant on agriculture than others, some of them may have severe soil erosion problems, many of them will have air pollution problems, and many of those air pollution problems will relate to varying mixes of industrial and transport pollution.

MS. MORRIS: In the follow-up I have to that, I just wonder--something as broad as the environment seems to be something rather difficult to take just case by case, and there is a Group of 24 effort, for example, looking at the environmental component, and I just would think that down the line, when we have to have a broader coordination of some of these answers--

MR. CONABLE: I'm sure there will be plenty of coordination. However, don't forget that the Bank deals with governments, and there is no regional government for Eastern Europe.

MR. WAPENHANS: Let me address the specific question. I think in the case of Poland--Poland is a good example--much of the pollution, and largely the pollution, is location-specific, and source-specific. So to sense the remedies, the remedies will have to applied in a specific locale, and in relation to a specific source of pollution.

Now, that doesn't take away from the need to coordinate and obtain actions in some, but in terms of, what do we do now, in the kind of pollution that Mr. Lari was referring to, especially, they are generated by power generation, to a large extent, based on coal, and soft coal, and it is something that will have to happen in those countries.

MR. CONABLE: And this is not unlike our project, which is only now getting under way for reducing the pollution of the Mediterranean. We don't, however, lend money to the Mediterranean Ocean--we lend it to the governments that surround it, and we will, obviously, try to do some coordinating, in that respect, because there is a common problem, namely the pollution of the Mediterranean.

Mr. Lari, did you want to deal with this?

MR. LARI: Two points. One, with the Eastern European countries which are members of the Bank, and with which we have an active lending program, in each of them we have operations addressing the issue of environment, particularly Hungary and Romania.

MR. CONABLE: No, Hungary is not--Romania has--

MR. LARI: Romania is wishful thinking right now.

MR. CONABLE: It is a member, but they don't have an active program.

MR. LARI: The second point, like Mr. Conable just said, whenever there is a regional aspect, like the Mediterranean area, we do take advantage of it to take a global view, and one where increasingly Poland and some of the northern countries have been talking to us is the issue of the Caspian--Baltic--the Baltic area, the Baltic Sea, and there is a possibility of some development in that area in the future, on a regional basis.

MR. AGUIRRE-SACASA: You're next over here, sir.

MR. LYLE: Going back to the specific lending you've got today, the largest one seems to be going to the National Bank of Poland. Will they be making decisions on which particular enterprises--

MR. CONABLE: Intermediary.

MR. LYLE: Will the World Bank have some role in that? And is there some plan breakdown between the existing public sector countries going private and new enterprises?

MR. CONABLE: Mr. Lari.

MR. LARI: Most of the enterprises have been already appraised. They were appraised by the World Bank-Polish joint missions, and for the rest you have very stringent economic and financial criteria. The loans are open to all types of enterprises, including what we might call private enterprises, and joint ventures.

MR. CONABLE: Joint ventures are a possibility here. But the bank is the intermediary, and is handling the money on our behalf, subject to the--

MR. LYLE: But the end use is being decided as part of the overall--

MR. CONABLE: Yes, yes.

MR. AGUIRRE-SACASA: Yes, sir.

MR. TURNER: These loans are being made against the background of the Polish inability to pay other loans that--repay money that it already owes. Why are these loans desirable under that circumstance? And the second question is, do expect that these loans will trigger American private banking interest in Poland?

MR. CONABLE: It would be our expectation that private commercial bank lending is likely to move slowly, and would be dependent on progress in Poland's dealing with its economic problems.

Of course, it is our expectation that there will be considerable progress made, and the Polish program which has been announced and not fully implemented as yet, which was characterized yesterday by the acceptance by the IMF of a major standby, as you know.

In other words, we are beginning a process here, for which we must have continued progress, and these loans are based on the expectation that progress will be forthcoming. Assuming the progress is forthcoming, we expect then to expand both the scope and the number of activities for which we will be lending in Poland.

MR. AGUIRRE-SACASA: Ms. Sparks, you're next on the list.

MS. SPARKS: I wouldn't mind following up, actually, on Doug's first question, which was about lending to Poland given its present indebtedness, but my question concerns--you mentioned $2.5 billion for Poland, and it may be too soon to answer this, but I wonder if you've run any preliminary numbers on Eastern European lending as a whole, and what this might do for the rest of the capital--your current capital, and replenishment?

MR. CONABLE: Well, obviously there is a problem for Poland. It has a very significant build-up of debt, which is coming due in the next three years. It's something in excess of $20 billion coming due in the next three years, and that will have to be rescheduled, or some degree of debt reduction will have to be brought about--debt relief, in any event, because it exceeds Poland's capacity to meet the debt service requirements, and to make the investments necessary for growth.

So, clearly, there is an expectation that Poland will continue its negotiations and bring them to fruition, with both the Club of Paris and the Club of London.

Now, as to what our figures are for all of Eastern Europe, that is highly conjectural at this point. We don't even know for sure which countries will be members. We have ongoing programs in Yugoslavia and Hungary at the present time. Czechoslovakia has applied for membership in the IMF and the World Bank; we can't be sure what their per capita income is, and therefore what their relationship to the Bank will be.

That will be determined during the spring, and possibly even the early summer, by investigation by the IMF, as to what a reasonable exchange rate is and so forth.

As to Romania, Romania is a member, but it has been an inactive member. It prepaid all its loans last year, for reasons that are too complicated to get into, with the result that it owes no debt at the present time to the World Bank, but as a member has the right to expect, given changed conditions in Romania, that it will have international support. And so we're willing to discuss with them the possibility of a new program in Romania.

As to Bulgaria, we have had some indications of interest on their part, but they have not yet made an application for membership, nor has East Germany.

MS. SPARKS: I guess what I'm asking is, would the potential for sudden increase in demand--do you have any cash restraints yourselves?

MR. CONABLE: No, I think we have no particular problem. The World Bank is organized regionally. As you know, we have major resources, it's not a zero-sum game. During the last three years our lending has increased by ten percent a year, and we intend to meet our global responsibilities.

Now, in discussing Eastern Europe, where obviously we have every intention of being relevant, and where we have every intention of mounting a campaign appropriate to those countries' needs and wishes--a program, excuse me, not a campaign--despite that we must keep in mind that we have global responsibilities, that our business is fighting poverty, that there are a great many poor people in Asia and Africa and Latin America who expect continued support from the Bank.

And so it is my expectation that we will not rob them in order to meet the current high level of excitement and interest in Eastern Europe. That does not in any way diminish our determination to be useful to Eastern Europe.

MR. AGUIRRE-SACASA: Mr. Brezini, you're next.

MR. BREZINI: A transition to a market system is, in a sense, something new--

MR. CONABLE: Very complicated.

MR. BREZINI: Yes, and some European countries have a great deal of experience with indicative planning--for instance, France. Some other European countries--Italy, for instance--have a large state sector and a large role for the state in the economy.

Would some of this experience be useful for a country like Poland?

MR. CONABLE: I have no doubt it would, and I have no doubt that there will be many participants in any Polish program, including bilateral donors, as well as multilateral donors. The World Bank will try to coordinate its aid with that of others, and will try and take advantage of the experience of others.

I want to point out, however, that we have 44 years of experience ourselves in economic issues, in the organization of economic issues, and that this differs only in degree from the problems we have had in many of our member countries in efforts to achieve greater economic efficiency.

MR. AGUIRRE-SACASA: I think we have a question over here.

MS. DUNNE: I wonder if you ever got to the place where there was some sort of resource freeze, whether the money that might have gone to China might go into Eastern Europe, and whether you think you might go back into China sometime soon?

MR. CONABLE: It is our expectation that China lending will be resumed in the not too distant future. We have a potential program in China, it will reflect the economic program of China, and clearly, at this point, it would be inappropriate for us to try to reallocate staff which has been reviewing the China program on account of anything that's going on somewhere else in the world.

But you know, all lending is conditioned on performance of an economic sort, and from time to time we have to reallocate staff because of performing problems in various parts of the world. We are a big bureaucracy, of course, and sometimes these things move slowly, but we have the capacity to reallocate, and it's entirely an appropriate thing to do.

MR. NORMAN: What are the prospects that you will apply these two loans this week? The $90 million coming before the Board on the 8th?

MR. CONABLE: I'm sorry, I didn't understand your question.

MR. NORMAN: I understood you had two loans to China coming up this week before the Board. Are they likely to be approved?

MR. CONABLE: We'll discuss that at an appropriate time.

MR. NORMAN: How about today?

[Laughter.]

MR. CONABLE: They are pending.

MR. AGUIRRE-SACASA: Mr. Turner.

MR. TURNER: But along the same line, are those two loans going to be discussed at the Board on Thursday?

MR. CONABLE: We will set the agenda tomorrow.

MR. AGUIRRE-SACASA: Mr. Farnsworth.

MR. FARNSWORTH: A few questions--two brief questions, sir. It's been reported in the press that you used a figure of about $7 billion over three years that you anticipate lending in Eastern Europe. I just wondered--

MR. CONABLE: I don't know where that report came from. I did say that we expected to lend about $7 billion to Mexico over the next three years, but it's entirely possible that I had some language difficulty in Mexico City.

[Laughter.]

MR. FARNSWORTH: So that $7 billion should not be used in terms of Eastern Europe.

MR. CONABLE: It should not be.

MR. FARNSWORTH: Okay.

MR. CONABLE: I think that would be highly speculative to try to put a figure on Eastern European lending at this point.

MR. FARNSWORTH: All right. And the second question is--

MR. CONABLE: However, we will stand by the figure that's put out here today on Poland, and, clearly, we will have significant programs in both Hungary on Yugoslavia, regardless of applications for additional membership.

MR. BREZINI: I'll follow up on that. What is the amount of the adjustment loan you expect to approve?

MR. CONABLE: I think it's too early to say. It will have to be negotiated.

MR. FARNSWORTH: A second point, you say that there's no problem in terms of resources of the Bank in meeting any future needs that--

MR. CONABLE: At this point.

MR. FARNSWORTH: Yes, at this point. I wondered if you'd comment a little bit about the question of the competition on the capital side. In other words, here you have Eastern Europe sort of in a global competition for capital type funds. How will this affect the competition for these funds in other parts of the world, such as Asia, Africa, et cetera?

MR. CONABLE: I've been asked about this everywhere I've gone recently, by people concerned that somehow, because of the great interest in Eastern Europe, they will be shortchanged with respect to their expectations.

What I say is this. The Bank is organized regionally, it is not a zero-sum game for us, we expect to be able to meet our global obligations, and we believe sincerely that we do have global obligations.

However, I say to the people of these other countries that are asking about it, that private investment is a voluntary investment, that it is a challenge for the entire developing world to create an attractive environment into which private capital will flow voluntarily, and that obviously, if many people are interested in the potential quick turn-around time for consumer goods starved Eastern Europeans, they are likely to make investments there unless other countries make a very strong effort to attract private investment.

And so there is a challenge to the developing world, at a time when most of the additionality(?) in the development of investment is going to come from the private sector. I say that because of the pressure on official development aid, fiscally, in most of our major donor countries.

They do not have significant additional amounts of money--at least at this point--perhaps they will later--to put into foreign aid generally. And therefore, the private sector is going to have to provide the dynamic, the incremental money for investment. And that should be a challenge for any country which wants more investment in development, and knows it cannot depend on significant additional amounts of official development aid.

So, I say to the Africans, I say to the Mexicans, I say to the Asians, if you do not work very hard to attract private investment flows there is always the chance that businessmen will think the atmosphere of Eastern Europe is more attractive.

Now, it will be more attractive unless Eastern Europe restructures itself in ways that will make it apparent that business can find a favorable environment for profit making.

MR. AGUIRRE-SACASA: One last question.

MR. TURNER: I wondered if you could tell us about your trip to Poland and Eastern Europe, what the itinerary involves?

MR. CONABLE: It is still in the process of formulation. I expect to go there to sign these loans that were passed today, and at that time, in Warsaw, I'll be able to make a more comprehensive statement about our expectations, in Eastern Europe and in Poland.

MR. TURNER: When will that be?

MR. CONABLE: That will be about two weeks from now.

MR. AGUIRRE-SACASA: Thank you very much. I would remind you that there is a copy of the statement outside for all of you.

[Whereupon, at 4:38 p.m., the press conference was concluded.]

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Poland

The World Bank
Washington, D.C. 20433
U.S.A.

Office of the President

December 5, 1989

Barber:

Re: <u>Volcker Visit</u>

You should be aware that Paul Volcker was in Poland and attached is Stan's back-to-office report which also includes major points he raised.

In addition to Poland, I think it would be urgent to review with him:

(a) a debt rescheduling and adjustment plan for Eastern Europe as a whole, including Hungary, Yugoslavia and the USSR;

(b) progress or non-progress on Mexico;

(c) likely developments in Venezuela, Argentina and Brazil. I understand that the situation in Argentina is again falling apart. No progress has been made in Brazil on the political front.

Marianne

DRAFT

Confidential

DATE: December 5 1989

TO: Messrs Conable, Thalwitz

FROM: Stanley Fischer

PHONE: 33774

SUBJECT: Back-to-Office Report from Poland

1. At the invitation of Minister without Portfolio Trzeciakowski, I visited Poland from December 1-3, to attend a conference on Poland's stabilization program. Mr. Trzeciakowski, aided by Professor Stanislaw Wellisz of Columbia University, invited a group of outside experts, consisting of current and former policymakers, and economic advisers with academic links, plus assorted others including George Soros; they are listed in the attachment. Formally, this was the first meeting of the new Economic Advisory Council to the Polish Government, which consists of seventeen Polish professors, all of whom attended the conference; their names are also listed in the attachment. However the discussion was dominated by the foreign participants. The foreign visitors had a two hour meeting with National Bank Governor Baka on December 1; Mr. Baka also attended the first part of the December 2 conference. The conference was opened by Prime Minister Mazowiecki. Mr. Baka was there for most of the morning of December 2, and Finance Minister Balcerowicz attended the last few hours. Messrs Bruno, Frenkel, Sachs and I met privately with Mr. Balcerowicz after the conference, to discuss some of the difficulties of the plan that had emerged during the discussion. Bruno, Frenkel and I also had two meetings with Mr. Russo, who arrived on Saturday, December 2 but did not attend the conference. In addition I briefed the Bank team preparing the SAL under the leadership of Ulrich Thumm, on the night of December 3.

2. After the opening statement by the Prime Minister, in which he expressed his government's determination to press ahead with radical economc reform, Mr. Misiac, Deputy Finance Minister, responsible for the budget, described current plans: he said that there is a planned deficit of only 0.6% of GNP, and that the budget includes provision for an unemployment safety net, based on the assumption of unemployment of 5% of the industrial labor force, as well a fund for the reconstruction of industry. It later emerged that the budget includes as revenues the sales of bonds, but we did not succeed in getting a definite estimate of the correctly measured deficit. Nor did we discover whether they believed they had closed off all direct and indirect sources of credit from the central bank to commercial

banks and enterprises, despite the question having been asked four different ways. We were next given a data-intensive exposition of the latest information on the economy, most of which is bad news, except perhaps for the appreciation of the free zloty. After these presentations, Paul Volcker took over as chairman. Rather than describe the discussion, I will present important points that emerged during the day.

3. The Exchange Rate and the Fundamentals: The Polish participants kept asking us to say whether the exchange rate should be fixed as part of the stabilization package. Outside participants emphasized that this could not be done unless certain fundamentals were in place, particularly a budget that was near balance and some assurance that the supply of credit from the National Bank was under control. During the day a consensus developed that the price of coal should be adjusted (it has to rise in real terms by a factor of five) as soon as possible, and in any case before stabilization is attempted. Several outside participants included significant enterprise and labor market reform among the fundamentals, but this view was generally disputed, on the grounds that enterprise and labor market reform would be more difficult to carry out against a background of high and unstable inflation than with relative stability of the price level. Alan Walters doubted that the exchange rate should be fixed as part of the stabilization effort, saying that both the U.K. and Chile had made bad mistakes by fixing the nominal exchange rate.

4. Wages: The most important point to emerge during the discussion was that wage policy had not been thought through. The issue of wage behavior emerged from a series of questions focussing on an inflation forecast implicit in the budget (which was to be presented in nominal terms) of 46% inflation in January, 23% in February, 11% in March, and then 3-5% per month. Stan Wellisz kept asking how this could be consistent with a fixed exchange rate. The answers that appeared to emerge were that (a) wages would be adjusted by an indexing formula that raised the nominal wage each month by 0.7 times the previous month's inflation, and (b) the exchange rate was projected to change from 11,000 Zl/$ to 17,000 over the course of the year. This information caused consternation, since backward indexing is a surefire way of both dragging out a stabilization program and of raising the real wage in the process. Most participants argued instead for a substantial increase in the nominal wage in January, calculated in conjunction with that month's expected inflation to achieve a target real wage, and thereafter to provide some guarantee that the real wage would not be allowed to fall below a certain level. During the discussion we were at some stages told that the wage would be indexed to expected inflation (a far preferable choice); in addition, the plan was to use a TIP (tax incentive policy) to control wage increases by taxing wage increases in excess of the specified targets. Paul Volcker, who had considered TIP in the US in the late seventies, and most others, were deeply sceptical, particularly

because the capacity of the tax authorities to collect from enterprises is uncertain. The wage issue was one of the main points of our private meeting with the Finance Minister; in that meeting he said that he would go for the up-front nominal wage adjustment plus guaranteed floor wage favored by most participants. However since most participants also emphasized the need for worker (or social partner) agreement on the wage policy, and since Lech Walesa has said there will be no wage freeze, the question of wage behavior during the stabilization attempt is far from settled. It is nonetheless crucial.

5. When Mr. Balcerowicz arrived, Paul Volcker presented an accurate six-point summary of the discussion:
(1) All stabilization programs have a large political element; outside advisers may be good for advice, but the Polish government will have to decide what it can do, and what compromises are needed.
(2) On the fundamentals: if the budget picture we were given is right, it is in good shape; similarly on monetary policy, where the National Bank was saying all the right things; but there was considerable scepticism about wage policy.
(3) Early success in stabilizations is relatively easy, but it can breed complacency or political pressures that tend to undermine the stabilization.
(4) The predominant view, which he shared, was that the exchange rate should be fixed early in the stabilization program.
(5) The Polish government should rely to a considerable extent on outside technical assistance to help restructure the banking and enterprise systems (he did not mention the World Bank at this stage).
(6) Outside financial help matters a great deal, especially since it is important to get goods on the shelves quickly.

6. Some other points made during the discussion are:
(1) Professor Kurowski, one of the Polish Economic Advisers, made a cogent presentation of the problesm of the stabilization, ending with the debt problem. This point was not picked up by anyone else, though corridor talk was that the Poles would not have to pay much interest for the next few years.
(2) Several participants, including Mr. Ruding, were very concerned about raising real interest rates. Michael Bruno suggested taking no special action to that effect, since real interest rates always rise at the start of stabilizations; the prioblem will be to get them down, not up. This fact of life did not seem to penetrate as throughly as it should have.
(3) Balcerowicz and his team were simply too busy to be able to do the needed work on the plan. This is a very serious problem, which came up in our later disvcussions with Mr. Russo.
(4) Alan Walters very effectively argued that privatization is a long and slow process, and that it was preferable for the government to restore firms to health before selling them. The Poles have not got far in thinking about the substance of privatization.

(5) Bill Rhodes said that Citibank wants to help the Polish economy by opening a branch for local operations. Paul Volcker said that Citibank rushes in where angels fear to tread.
(6) Jeff Sachs is very anxious to move ahead fast, claiming that it is not true that most countries had their budgets in order when they stabilized, and that the Poles basically were ready. (He is right that the success of stabilizations is determined as much by the ability of the government to handle policy problems after stabilization as before, and that some stabilizations have started with the budget in disarray, but wrong on the political economy of leaving budgetary problems to be handled later.) However at various points he also confessed to being very worried, especially over the lack of clarity on wages.

7. We met Mr. Russo both before and after his first day of meetings. He is extremely concerned at the state of the budget, stating that the numbers we were given were not based on any concrete plan of action, and were inconsistent. At our second meeting he said he had persuaded Balcerowicz to delay presentation of the budget, which had been due this week. He expects to leave on Decmber 15, after receiving M. Camdessus in Warsaw on December 13. This implies that a standby will be signed, but there is much work to be done before then. I suggested to Russo that it would be preferable to wait a month than to go ahead with the Poles unprepared, but he didn't think an extra month would help; January 1 is the more likely data also because the fiscal year and the new indexing agreement both start then.

8. <u>Real Devaluation</u>: One is struck in Poland by the extraordinarily low prices of most commodities, when measured in dollars: the average wage is about $20 per month. Measured in purchasing power parity (PPP) terms, the parallel exchange rate appears to the casual observer to be undervalued by a factor of at least 5, and even the official rate is hugely undervalued. The reason must be that the parallel rate is determined largely by speculative, capital market, forces, and very little by the current account and its prospects. This suggests that a stabilization might well be followed by a substantial real appreciation, and that everyone's prescription that the stabilization has to start with a significant real and nominal devaluation that goes beyond unification of the rates somewhere bettwen the official and parallel rates may be wrong. If so, stabilization would be much easier. We discussed this issue with Mr. Russo, and some of us are planning to pursue it further in research.

cc: Messrs Qureshi, Wapenhans, Lari, Holsen, Ms. Haug.

Preliminary List of Outside Participants

Michael Bruno, Governor of the Bank of Israel

Stanley Fischer, World Bank

Jacob Frenkel, IMF

Stanislaw Gomulka, LSE (currently on leave at Harvard)

Douglas Gustafson, IFC

Henryk Kierszkowski, IUHEI, Geneva

Michael Lav, World Bank

William Rhodes, Citibank

Jeffrey Sachs, Harvard University

George Soros

Paul Volcker, Princeton University

Alan Walters, Johns Hopkins University

Stanislaw Wellisz, Columbia University

~~(1) MH~~
(2) ~~LMT~~
(trip file)

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 90/02/16 DUE DATE : 00/00/00
LOG NUMBER : 900216005 FROM : Mr. Aguirre-Sacasa
SUBJECT : Polish Unemployment in Perspective

file

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

	APPROVED
	PLEASE HANDLE
✓	FOR YOUR INFORMATION
	FOR YOUR REVIEW AND RECOMMENDATION
	FOR THE FILES
	PLEASE DISCUSS WITH ____________
	PLEASE PREPARE RESPONSE FOR ____________ SIGNATURE
	AS WE DISCUSSED
	RETURN TO ____________

COMMENTS :

also copied to M. Haug

Copy in trip book already.

URGENT

February 16, 1990

Mr. Conable:

Barber:

Polish Unemployment in Perspective

1. As you know, the Polish Press has reported that the Bank estimates that Polish unemployment may rise to 1.7 million persons, equivalent to 10% of the work force.

2. This report has created a stir in Poland, especially since earlier estimates of possible unemployment were much lower (400,000 was a figure frequently cited, albeit not by the Bank). You will be briefed fully on this issue by Bank staff when you arrive in Warsaw. The purpose of this, note, however, is to put that 10% figure into some perspective.

3. According to the latest OECD estimates, there are six OECD member countries whose 1988 unemployment figures topped 10%. Some of these may surprise you. They were:

Country	Unemployment Rate
Spain	20.1
Ireland	17.6
Turkey	14.8
Italy	11.9
France	10.3
Belgium	10.2

A number of other OECD countries had rates that approached 10%. These include the Netherlands with 9.5% unemployment and the U.K. with 8.3%. Even the Federal Republic of Germany, Europe's largest and strongest economy, had unemployment of 6.2%.

4. Viewed against the figures cited above, an unemployment rate of 400,000 (2% of the work force) was clearly unrealistic and 10% seems, if anything, optimistic considering the weakness of the Polish economy and the magnitude of adjustment that it must undergo.

5. I recommend stressing two messages in discussing adjustment and unemployment. The first is that steps must be taken to mitigate the social costs of adjustment and that you are pleased that the Government is building a social "safety net" into its adjustment programs. The Bank will

support Poland in this effort. The second is that a sustained program of policy reforms --coupled with far reaching institutional changes and high priority investments-- should put Poland on a sustained growth path in the medium term. This, in turn, should allow unemployment levels to decline even as living conditions for the bulk of the population improve noticeably. All this will take time, perseverance and sacrifice, though, in the coming months and years.

FAS
Francisco Aguirre-Sacasa

cc: Mr. Thalwitz and Ms. Haug

co. file

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

February 28, 1990

Monsignor Bronislaw Dabrowski
Skew Ks. Kard. S. Wyszynskiego, 6
01-015 Warsaw
Poland

Excellency:

It was my great pleasure to meet with you during my recent visit to Poland. I found your comments on the state of Polish society and its support for reforms to be enlightening and encouraging.

I share your view that difficult times will be with Poland for a while as it attempts to reconstitute its infrastructure so that the whole of society can function better and quickly adapt to the new economic regime. I can assure you that the World Bank will extend generously its support as long as the Government persists on its course of reforms to bring a better life for the Polish people.

Thank you very much for the medal honoring the Pope's visit to Czestochowa.

With very best regards,

Sincerely,

Barber Conable

~~MH~~
~~BBC~~
MF-file

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: October 2, 1989

TO: Memorandum for the Record

FROM: Eugenio F. Lari, Director EM4

EXTENSION: 32552

SUBJECT: POLAND: 1989 Annual Meetings
Meeting with Mr. Conable and the Polish Delegation.

Attendance

Delegation	Bank
Prof. Wladyslaw Baka, President NBP	Mr. Conable
Mr. Grzegorz Wojtowicz, Vice President NBP	Mr. Qureshi, OPNSV
Ambassador Jan Kinast	Mr. Draghi, Executive Director
	Mr. Ilczuk, Advisor
	Mr. Fischer, DECVP
	Mr. Thalwitz, EMNVP
	Mr. Stanton, EXC
	Mr. Vergin, OPNSV
	Mr. Lari, EM4DR

1. Mr. Conable welcomed Prof. Baka and asked him about the reform programs in Poland and their implementation plans. He stated that once the IMF granted Poland a Standby, the Bank would go ahead with project lending. Later, in the next fiscal year, the Bank could consider a larger program, including policy-based lending. But ultimately the program of reforms was Poland's responsibility.

2. He went on to comment on the very high expectations of the Polish people and on the need for Poland to coordinate all the aid programs now being offered, to avoid waste of resources, missing opportunities to establish priorities and meet the most immediate needs, and even having a negative impact on potentially very useful assistance from other sources, e.g. the Bank.

3. Prof. Baka replied by expressing general concurrence with Mr. Conable's observations. In turn, he observed that for the moment the Polish Government enjoyed great popular support, but that this could rapidly be eroded if positive economic results were not visible in the near future. Failure of the Polish reform, he added, would have a negative impact beyond Poland's frontiers.

4. Prof. Baka went on to describe the reform program: the legal framework to support the activities of private enterprises was in place; indeed some private enterprises had already appeared; foreign trade had been virtually totally liberalized; prices had been or were being decontrolled; demonopolization was ongoing. Unfortunately hyperinflation had begun, in response of internal imbalances, which was socially very dangerous.

5. The reform was taking place along three fundamental lines: (a) stabilization (through strict fiscal and monetary policies, positive real interest rates, financial discipline for the enterprises, measures to reduce their liquidity, gradual reduction of subsidies, and forthcoming convertibility of the Zloty--all of this to be in place in the first quarter of 1990); (b) structural adjustment (privatization and demonopolization); (c) social security, targetted to the groups who would mostly bear the costs of the reform.

6. Recognizing that the reform was mainly Poland's responsibility, Prof. Baka stressed the need for foreign aid to ensure its success. He expected agreement on a Standby from the IMF in a few weeks, to be accompanied by Bank project lending and reasonable arrangements with the Paris Club. He looked for Bank loans in the course of the year, given their expected catalytic impact on the commercial banks, which had indicated to him that they would follow the Bank's lead. He also hoped that work on future SALs and SECALs (especially for energy conservation, environment protection, and food processing) would start soon. The Government program, he added, was centered on developing exports, for which he expected Bank financial assistance and advice.

7. Prof. Baka, after noting the good cooperation with IFC and the impending ratification of Poland's membership in MIGA, praised the technical assistance and policy advice received in the past from the Bank staff. He then asked that the Bank give full support to a team of renowned economist of Polish origin being organized by Prof. Wellisz of Columbia University to give policy advice to the Polish Government.

8. He also asked for Bank technical and financial assistance in the development of the banking system, regarding concepts, staff training, and equipment--similar to what the Bank is doing in Hungary. He considered the issue of aid coordination crucial and planned to discuss it more in detail with Mr. Thalwitz during his visit to Poland in mid-October. The Government was bent on preventing the bad experience of the 1970's, when foreign loans were squandered. The Bank could perhaps coordinate technical assistance in general and play directly a central role in the plan of institutional changes.

9. Mr. Qureshi stressed that a good deal of work was needed in Poland to prepare the ground for Bank assistance in the form of SALs or SECALs, which presuppose well-conceived and feasible structural adjustment programs.

10. Prof. Baka replied that some studies had already been prepared, e.g. in the field of energy (energy conservation; closing down of mines) and industry, the latter being based on the seminal Bank study on how to improve industrial efficiency in Poland. He concluded by inviting Mr. Conable to visit Poland.

11. Queried by Mr. Conable, Mr. Fischer stated that the sequencing of the reform proposed by Prof. Baka seemed all right, in particular the emphasis on stabilization, followed by the reform on the financial system.

12. Concluding the meeting, Mr. Conable accepted "in principle" the invitation to visit Poland, stated the Bank's firm intention to help Poland--hand-in-hand with the IMF--, and declared that he would allocate adequate resources, under a carefully staged plan, to meet Poland's needs and expectations.

EFLari:nsp

cc: Messrs. Conable, Stanton (EXC); Qureshi, Vergin (OPNSV); Fischer (DECVP); Thalwitz, Hasan, El-Maaroufi (EMNVP); Bouhaouala, Hinds, Amin, Baudon (EMT); Zaidan, Thumm (EM4DR); Nouvel, Ramasubbu, Sood, Apitz (EM4); Poland Country Team (EM4COD).

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Poland - Country Files - Correspondence - Volume 1	1779845

Document Date	Document Type
November 20, 1989	Letter

Correspondents / Participants

From: President Barber Conable

To: Mr. Spraw Zagranicznych, Minister of Foreign Affairs, Poland

Subject / Title

Appointment of Governor of the WBG

Exception(s)

Additional Comments

Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Ann May	September 28, 2015

Archives 1 (August 2014)

Embassy of the Polish People's Republic
OFFICE OF THE ECONOMIC COUNSELOR
2224 Wyoming Ave., NW Washington, DC 20008
Ph. (202) 232-4517, 232-4528, Fax 328-6271
Tlx 089480 poimission wsh

Washington,October 30,1989.

BRE/108/89

The Honorable

Barber B.Conable

President of the International Bank
for Reconstruction and Development

Washington,D.C. 20433

Excellency,

In last diplomatic pouch, Ministry of Foreign Affairs in Poland transmitted to me, with meaning delay, the enclosed letter signed by prof.dr Krzysztof Skubiszewski.Minister of Foreign Affairs, dated September 21st.1989.

It is my pleasure to deliver to your hands the above mentioned letter.

Yours most respectfully,

Bazyli Samojlik
Economic Counselor
Minister Plenipotentiary

Encl.

Minister Spraw Zagranicznych

Warsaw, September 21st, 1989

Excellency,

I have the honour to notify, that the Government of the Polish People´s Republic has recalled Mr. Zdzisław PAKUŁA and appointed Mr. Władysław BAKA, President of the National Bank of Poland as Governor of the International Bank for Reconstruction and Development, with effect from 12 September, 1989.

Accept, Excellency, the renewed assurances of my highest consideration.

Krzysztof Skubiszewski

The Honorable
Mr. Barber B.Conable
President of the International Bank
for Reconstruction and Development
Washington, D.C. 20433

Record Removal Notice

The World Bank Group Archives & Records Management

File Title Poland - Country Files - Correspondence - Volume 1	**Barcode No.** 1779845
Document Date November 20, 1989	**Document Type** Letter

Correspondents / Participants
From: President Barber Conable
To: Mr. Wladyslaw Baka, President, National Bank of Poland

Subject / Title
Appointment of Governor of the WBG

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Ann May	September 28, 2015

Poland

United States Department of State

Under Secretary of State
for Economic Affairs

Washington, D.C. 20520

August 7, 1989

Dear Barber:

Before too long, I'm going to be joining you on vacation (in upstate Pennsylvania) but I thought I would touch base with you briefly before I head off on the subject of our last conversation.

I mentioned our hope that you would be able to pass through Poland in the not too distant future, and say a word or two to the Polish people via television about the importance of economic reform.

The basic condition that you laid down to me in your office for such a visit seemed very reasonable. And I see no reason why the format you described could not be arranged in any number of ways, once we have some sense of your timing.

I know that you have a number of pending projects in Poland. Visiting Polish officials to discuss these projects could serve as the rationale for your visit. The interview or discussion on economic reforms could flow as a secondary element, from the point of view of perceptions. I hope that something along these lines can be arranged.

What is happening in Poland is potentially one of the most important events since the end of the Second World War. In combination with other elements, these changes can dramatically reduce tensions in Europe for the long term.

Economic disaster in Poland, on the other hand, could unleash a series of unpredictable events.

What outsiders do or do not do are on the margin. Central to everything is internal Polish reform on basic economic matters. Words from you could carry important weight.

No one here would presume to suggest precisely what you might say by way of advancing the cause of economic reform. Your own knowledge and political skills, combined with technical advice from your institution would be the best judge of that.

But I do hope that you will be able to take the occasion of your September trip to Japan to pass through Poland on your return and carry through on the President's discussion. It is important that there be some follow up on this. Let me know what you think.

Dick

Richard T. McCormack

Mr. Barber Conable,
P. O. Box 218,
10532 Alexander Road,
Alexander, New York 14005.

COUNTRY: POLAND

DELEGATION:
Mr. Zdzislaw Pakula, President, National Bank of Poland

Friday 9/29 @ 10:15 a.m.

BACKGROUND

- New Solidarity-led Government took over earlier this month. Wants to move quickly to address economic problems.
- Economic situation has been deteriorating: slow growth and rising inflation.
- Stabilization/Adjustment Program is first priority of new Government.
- IBRD lending conditioned on implementation of a credible IMF supported medium-term program under discussion. (Have extended a PPF $1.5 million and IFC has financed one project $18 million).
- Two Bank loans ($300 million) are ready to negotiate; also a solid pipeline.

POINTS TO BE MADE TO THE DELEGATION

Medium-Term Reform Prospects: Inquire about current domestic political situation and its effects, if any, on the stabilization strategy.

- How does the Government intend to continue conceptual and organizational work to sustain pace of system reforms.
- Observe that an acceptable medium-term plan constitutes the focal point for Bank/Fund assistance.
- New CEM looks at medium-term issues and will be discussed with Government in October/November.

Strategy for Dealing with Creditors: Inquire about Government's strategy towards each major creditor group and their expectations of support.

- How does the Government intend to marshall the potentially large concessional and financial assistance.
- Offer World Bank assistance in this coordination effort.

IF DELEGATION MENTIONS...

Scope/Timing of Bank Lending for two loans ready for negotiation.

YOU MAY INDICATE that the Bank intends to invite negotiations after basic ingredients of stabilization program are agreed with IMF.

- Present to Board once standby is scheduled for IMF Board discussion.
- Note post-appraisal mission was in Poland in early September.

Request for a SAL which has been made earlier.

YOU MAY SAY that we have variety of lending instruments which may be used.

- We look forward to getting lending program started first and future content and level should emerge after further consultations.

Prospects for Brady Plan Support:

YOU SHOULD SAY that the key to eligibility is the establishment of a viable macroeconomic plan.

- Once Poland agrees with IMF/Bank on a medium-term program we are willing to explore Brady Plan prospects but preliminary calculations indicate only modest benefits.

FY89 Commitments: --	**GDP Growth:** 1.7% (1989); 3.9% (84-88)
Disbursements : --	**Lending Program (FY90-91):** $905 million
Amortization : --	

September 28, 1989

(10:15 am)

POLAND

Update to Senior Management Brief

Latest Developments:

1. Polish authorities presented a good outline of their proposed program for stabilization and restructuring. The main thrust is on the importance of the market mechanism and privatization. Continuing close consultations with IMF and WB will be important to complete preparation of technical aspects of the macromanagement program (such as currency reform), and of a specific action plan.

2. IMF Article IV consultation mission (with Bank participation) is scheduled for October 10 for 2-3 weeks. Possible Camdessus mission is under discussion; Thalwitz mission is scheduled for October 19. IMF Standby could be approved in December/January; Bank loans could be at the Board at the same time. Paris Club is ready to hold restructuring meeting after agreement with the IMF.

3. Continued high level interest from bilaterals, but coordination of efforts not well established. Polish capacity to coordinate technical assistance and financial support is weak. September 26 donors meeting organized by the EC indicated potential assistance of over $600m could be forthcoming, but details and timing remain uncertain.

4. Polish authorities have realistic expectations of potential timing and magnitude for initial Bank lending operations. Later, they would like expanded support (volume increase as well as policy-based operations) linked to the progress of the reform program in the next 6-12 months.

Issues to Emphasize

5. Urge the Polish authorities to proceed rapidly to complete their plans and start implementing them. Assure Prof. Baka that we understand that implementation of the reforms will take time and success may prove elusive at first. Process will require monitoring, readjustment and patience and we will provide advice and support.

6. Reassure Prof. Baka that the Bank is doing its best to have proposed lending operations for the Industrial Export Development and Agro-Industrial Export Development Projects ready for negotiations as soon as the overall program is clear and agreement is reached with the IMF.

7. Emphasize the need for concerted effort (Bank, IMF, Paris and London Clubs). Express our concern about the prospect for poor coordination of the large assistance which is becoming available and inquire what the Polish authorities intend to do and if they wish us to play a role vis a vis the EC initiative as well as the bilateral technical assistance offers.

International Finance Corporation
Washington, D.C. 20433
U.S.A.

Sir WILLIAM RYRIE
Executive Vice President

September 28, 1989

Mr. Barber Conable

Barber..

I understand that you will be meeting tomorrow with Mr. Baka, President of the National Bank of Poland. I thought you should know that, over the past few days, IFC had a number of very good meetings with the Polish Delegation (including Mr. Balcerowicz, Deputy Prime Minister and Minister of Finance, and Mr. Baka) and that we have agreed to a program of assistance to the Poles focussing on the following points:

1. A program of investments aimed at developing the country's private sector and at promoting joint ventures with foreign companies. This program has already begun with one investment in the horticultural sector and work is proceeding on several.

2. Assistance to the Government of Poland in the privatization of state-owned enterprises.

3. The creation of a new bank or banks, with the participation of foreign banks, so as to help modernize the financial sector and so provide a basis for the development of strong private companies in Poland.

4. Technical assistance in the development of capital markets.

5. Assistance with the establishment of an advisory service for Polish private companies, especially newly established businesses.

We shall be sending in the next couple of weeks two IFC teams to proceed with the implementation of this program.

At the invitation of the Polish delegation, I have also agreed to visit Poland some time next year.

Bill

BBC

September 21, 1989

TO: Mr. Barber B. Conable

POLAND: Strategy Note

I thought you might want to look at the attached strategy note before our meeting at 4:30 pm today. Moeen agrees with its conclusions provided:

(i) we shall not go ahead with project loans until a firm program is reasonably close to presentation to the IMF Board.

(ii) Since the IMF program might be short and weak, adjustment lending should not start until a deeper and more far-reaching IMF program (perhaps an EEF) can be put together.

Therefore, anything like $800 million is still rather remote.

Wilfried Thalwitz

Wilfried P. Thalwitz

Frank Hodsoll

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: September 20, 1989

NAME	ROOM NO.
Mr. Qureshi, OPNSV	E-1241

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		URGENT

REMARKS: POLAND--Strategy Note

Moeen, please look urgently at this note. I would like to have your guidance and, I hope, concurrence before I meet with the Polish Delegation at the Annual Meetings. Yesterday, in a meeting with Mr. McCormick (Under Secretary of State) in the office of Mr. Camdessus, attended by Eugenio Lari and Philippe Nouvel for the Bank, the Americans were assured of the IMF's intention to assist Poland, probably with a Standby in a few months, followed by an EFF. Everybody stressed the uncertainties of the situation and also the need for up-front gestures to provide visible, even if in some cases only symbolic support, to the new Government. Mr. Camdessus indicated that Barber Conable had told him that the Bank would accompany the IMF Standby with a SAL.

FROM: Wilfried P. Thalwitz	ROOM NO.: H12-071	EXTENSION: 32676

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: September 20, 1989

TO: Mr. Moeen Qureshi, Sr. Vice President, OPNSV

FROM: Wilfried P. Thalwitz, Vice President, EMN

EXTENSION: 32676

SUBJECT: POLAND: Strategy Note

The rapid political and economic developments in Poland, culminating in the election of a Solidarity led government committed to further economic reform, have resulted in mounting pressures for prompt and substantial external financial support and the need for the Bank to review its lending strategy to Poland. We have prepared this note to update you on the latest developments, to revisit our strategy, and to get your agreement. This strategy needs to ensure that we are able to respond effectively to the rapidly changing situation in Poland while preserving Bank financial integrity in the face of substantial country uncertainty.

The Setting

Poland at present is not creditworthy. Its debt burden is among the highest in the world, equivalent to about 60% of GDP at the official, greatly overvalued exchange rate (i.e. the burden is in reality much higher, well in excess of GDP), and its scheduled debt service payments, even after successive reschedulings, about 70% of convertible currency earnings (including remittances). Poland has, however, built up arrears with its Paris and London Club creditors. While it serviced its commercial bank debt until this spring under a London Club rescheduling, it deferred principal payments in April 1989 and missed the last interest payment in September (with further deferred payments during the remainder of the year likely).

On the economic side the situation has been mixed: The previous government had initiated a process of significant institutional reforms. A new legal framework supporting private sector activities has been established, central allocation of resources has been reduced, prices in agriculture have been liberalized, and the banking system has been reformed. The new laws and regulations, however, have not been implemented in many cases and financial discipline at the enterprise level is still lacking. At the same time, macroeconomic balances have deteriorated badly, partly as a result of the prolonged political negotiations last spring and the absence of an effective government this summer. The 1989 fiscal deficit is likely to be 7% of GDP compared to almost equilibrium last year, the positive external trade balance with hard currency countries has been cut in half as a result of surging consumer goods imports, inflation in August reached a monthly rate of 40%, and the exchange rate in the street is 8-10 times the official one.

Under these circumstances, Bank lending faces high risks. It can only occur as part of a concerted effort involving strong commitment to reform on the part of the new Polish Government as well as important financial contributions by Poland's creditors. If such an effort materialized, it would be possible to restore a sustainable growth rate and a return to creditworthiness in the late 1990's.

The new Government has forcefully stated its commitment to rapid economic reforms aiming at the establishment of a system in which markets play a major role. It has also succeeded in attracting some good and respected economists and technocrats, is seeking advice and help from Polish experts living abroad, and, for the time being, enjoys widespread support at home.

<u>Action by the Polish Authorities</u>

The Government can use all the help, advice, and support it can get, as it is facing a daunting task. It must redress the macroeconomic imbalances by introducing a series of stabilization measures that will require income sacrifices among its major constituency, labor. It must also address microeconomic issues of systemic reform which would lead to the restructuring of inefficient industries. This too will involve sacrifices by labor and can only occur if it is accompanied by a social policy package.

At present, <u>stabilization</u> should be the first order of business. A key objective should be the breaking and reversal of inflationary expectations. It is unclear how this is to be accomplished technically. For example, should a radical solution such as that which proved successful in Israel and Bolivia or a more gradual effort be undertaken? A lot would depend on the availability of external finance in support of a radical package. Whatever the technical attack on inflation, for stabilization to succeed, a number of other steps are essential:

- A major fiscal adjustment is needed involving substantial expenditure cuts, especially in subsidies;

- tight monetary policy with significant increases in interest rates which at the moment are substantially negative;

- tight credit policy to impose a hard budget constraint on individual enterprises;

- a large adjustment in the exchange rate; and

- a compact with labor to reduce real wages in the next 12-18 months and limit future wage increases to productivity growth.

Stabilization efforts will not be sustainable unless there is substantial supply response. The latter requires systemic reforms to transform the Polish economy to a decentralized, market oriented system. While some efforts in this direction had been initiated by previous governments, it is now needed to move forward in the following areas:

- Abandon government intervention and introduce a hard budget constraint at the enterprise level;

- Address the ownership question and explore alternatives to self-management by workers as the latter may inhibit capital and labor mobility;

- Introduce reforms in the foreign exchange and trade system which aim at reducing the bias against exports and stimulate competition in the domestic markets;

- Promote competitive structures in production and distribution;

- Undertake a tax reform, with expansion of income taxation and introduction of a value-added tax as well as strengthened tax administration;

- Strengthen the recently reformed financial system through portfolio restructuring and improved prudential regulations and accounting and auditing standards; and

- Establish a safety net to support displaced labor in restructured industries and increase labor mobility through training and provision of housing.

Action by the International Community

The Polish reform efforts need generous external financial support to allow the necessary time to yield the expected results. Financial support is needed both to make the stabilization credible and in order to permit expansion of imports to stimulate competition and to provide a breathing space until the domestic supply response materializes. The 1990-92 external financing requirements are estimated at about $17 billion (including a cumulative increase in reserves on the order of $1.6 billion) (details in Annex I). The bulk of this requirement would have to be financed through rescheduling and concessionary debt relief as it is inappropriate for the Polish economy to add to its already heavy debt burden. Preliminary estimates of requirements for financial support are as follows:

1. Paris Club. The Paris Club accounts for about two thirds of total debt. Currently Poland's debt-service obligations to Paris Club creditors amount to about $3.3 billion p.a., of which about $700 million (mostly interest) are in arrears. Relations with Paris Club members have improved, in spite of the arrears, with high level political support and continued tolerance of Poland's inability to make debt-service payments. Paris Club governments would be expected to reschedule all principal payments falling due for at least the next three years and provide exceptional relief on interest payments--or equivalent measures (which most likely would have to be handled on a bilateral rather than multilateral basis). An informal Paris Club meeting on Poland is planned for September 20, 1989.

2. London Club. Commercial bank debt is about one-fourth of total debt and debt service obligations are about $900 million per year (slightly less

than 10 percent of convertible currency earnings). Relations with commercial banks have deteriorated somewhat, as Poland told the banks that repayment of principal would be deferred and that it wished to avail itself of the treatment offered to other countries under the Brady Plan. Some type of debt service reduction scheme will have to be ultimately negotiated as part of an overall effort. The Polish authorities have requested a special meeting with the London Club steering committee which is now scheduled for October 3. New money would also be needed and could be mobilized through cofinancing with the Bank.

3. Western Bilaterals. New bilateral support (other than some food aid) has so far been slow to materialize in part pending clarification of the Government's programs, but also because of the donors' budgetary constraints. The G-7 have designated the European Community (EC) to take the lead in coordinating bilateral support for Poland (and Hungary). The EC has already held a meeting to which the Bank and the IMF have not been invited, although EC authorities have declared their intention to work closely with us and we have provided them with our economic and sector work. The next meeting, a high-level "technical" one, on both Poland and Hungary, is scheduled for September 26. Both the Bank and the Fund were invited to attend as observers. A high-level "political" meeting later on is expected to conclude with the authorization for the European Investment Bank to begin activities in Poland (and Hungary).

4. USSR. The Soviet Union generally has been supportive of the political and economic reforms, albeit within the boundaries of safeguarding Warsaw Pact obligations, and rescheduled about half of Poland's $3.2b hard currency debt. More may need to be done in the future.

5. The IMF would be expected to come up with a substantive Standby followed by an EFF arrangement on the order of up to 100 percent of quota per year, equivalent to $725 million, over a three-year period.

The Bank Lending Strategy

In Poland today, there is an urgent need for a prompt improvement in the supply of goods for the domestic market and for exports to hard currency markets. The Bank has a stock of projects in various stages of preparation which would result in a quick supply response. These projects alone would mean annual disbursements of about $300-400 million per year for the next three years. However, a good stabilization and restructuring program, forcefully implemented by the Government and strongly supported from abroad--with active Bank participation--could provide the basis for a larger lending program, including policy-based lending as early as in the first half of FY91. Total disbursements could then quickly reach about $600 million per year. In sum, provided a concerted effort along the above lines is undertaken, the Bank's proposed 1990-92 contribution (disbursements) could be on the order of $1.7 billion. Given the uncertainties in the Polish situation, we must retain flexibility in program implementation. Thus, we propose to initiate lending during FY90 with 3-4 well prepared project loans on the order of $300-500 million. The projects would be, to the extent possible, insulated from the distortions still prevailing in the Polish economy. Depending on the progress in the reform effort and the dialogue with the Polish authorities, we also propose to raise the investment project lending to $500 million during the following years and to add quick-disbursing policy-based loans in support of microeconomic and other systemic reform efforts on the order of $300 million. The proposed lending commitments would thus increase from about $300-500 million during FY90 to about $800 million during FY91-92. Details of the proposed investment project lending operations are shown in Annex II.

Substantial risks will persist for some time in the Polish economy. The continued presence in the Government of politicians and bureaucrats of the past, especially at the local level where municipal elections will not take place until next year, and the difficulties inherent in the transition from underground movement to government party represent serious risks in implementing the reforms, with occasional backsliding. These risks would of course become much greater, were the reform momentum in the USSR to be reversed. However, if the Polish adjustment program is pursued vigorously along the lines suggested above, and if there is international support, especially substantial debt relief, the Bank's exposure risk would be manageable, especially in light of the flexible lending strategy proposed.

Next Steps

Massimo Russo of the IMF is now visiting Poland and has reported from Warsaw positive impressions of the new Government's commitment to radical reform and acceptance of a tight income policy, but also lack so far of a specific action plan. Further, the IMF is planning to send a mission to Poland in late October for Article 4 consultations. Following this mission, work would be initiated for a Standby, which in turn may be necessary for Paris Club action. Such action may not result in concessionary debt service relief. Indeed, it is most likely that the G-7 will preserve the rescheduling norms of the Paris Club but take action bilaterally outside the Club. Such action, however, would be essential to the resolution of Poland's long-term financial difficulties. In parallel, the Polish authorities would need to reach agreement with the commercial banks. If a comprehensive debt reduction agreement cannot be reached until some experience with the macroeconomic stabilization has been gained, it may not be possible before next spring, at the earliest.

In the meantime, the Bank would be working with the Polish authorities for the development of a long-term program of adjustment, with special focus on how to achieve promptly changes at the microeconomic level and how to mitigate the social costs of the reform. Our projects, however, could be presented to the Board as soon as there is sufficient progress in obtaining an IMF Standby and there are clear indications that the Polish authorities are undertaking the necessary steps for macroeconomic stabilization and the requisite international support is forthcoming.

The Bank would also continue and intensify its coordination with the IMF (where cooperation has been very close both in Washington and in the field), and with the EEC, bilaterals, and commercial banks. With all of them we have initiated in the last three years a systematic exchange of information, economic and technical analyses, and general views. Cofinancing possibilities have already been identified, and would be now actively pursued in keeping with the pro-active role in support of Poland's reform efforts we propose that the Bank assume.

Provided we agree on the strategy, I propose to visit Poland in mid-October and discuss it with the Government. I would also stop in Brussels and have discussions with EEC authorities.

Let's discuss, please. You may wish to show this note to Barber.

Attachments

cc: Messrs./Msdms. Hasan, El-Maaroufi (EMNV); Nouvel (EM4)

Lari/Lav/Michalopoulos/Thumm:bp

ANNEX I

Tentative Financing Plan
(millions of $)

	--Improved Case--	
	1990-92	1993-95
Trade Surplus	702	3280
Transfers from abroad	4050	4050
Net service receipts (excluding interest)	584	782
NICA*	5336	8112
Interest Due	11543	12806
Amortization Due	9356	14578
Change in reserves (- = increase)	-1575	0
Financing Needs	17134	19272
Financing:		
Direct Foreign Investment	1400	2366
New MLT (including Bank)	2150	2400
Other	446	665
Rescheduling:	13130	13841
Interest	399	0
Amortization	6714	8624
Exceptional Interest Financing	6025	5217

* Non-interest current account balance

Memo Item:

	1990-92	1993-95
IMF financing for changes in reserve	2150	0

File: c:\lotus\financing

POLAND

PROPOSED PROJECTS

1. Industrial Export Development Project ($250m, 3Q FY90)
   Agro-Industrial Export Development Project ($50m, 3Q FY90)

Objective: Direct and quick expansion of net export earnings though financing of foreign exchange expenditures, such as debottlenecking investments and working capital to finance imported machinery, inputs, raw materials, spare parts, etc; and support to improve policies and institutions to foster private sector development. Although not technically a fast-disbursing operation, we expect the disbursement profile of World Bank funds to be faster than investment project norms given the nature of goods to be procured, good preparation by project entities and the fact that procurement for some components has been initiated already (and some contracts let) according to World Bank guidelines.

Special features: Despite the fact that World Bank funds would be channeled through the Polish banking system from the World Bank to the selected enterprises, nearly all of the funds would be allocated to enterprise investment proposals which have been already appraised by World Bank and shown to be economically viable. The financing terms will be insulated from the distortions of the Polish economy--with loan funds repayable in foreign exchange and at interest rates linked to World Bank lending terms. All eligible enterprises would need to be existing exporters with established international markets for their goods and the credit line is open to all ownership forms, including private sector. Technical assistance for upgrading capacities of domestic banking system, training/retraining to ameliorate the impact of industrial restructuring, as well as institutional support for the development of small and medium (likely private) enterprises also under discussion.

2. Environmental Technical Assistance ($5-10m, 3Q FY90)

Objective: Assistance in formulating an economic and operational framework for environmental work in Poland, defining activities and establishing priorities which would direct Poland's own programs and help marshal the considerable potential foreign assistance available for such activities. Activities would include, for example: (i) preparation of a plan for restructuring water resources management on a basin approach; (ii) strengthening the regulatory capacity of the Ministry of Environment; (iii) development of least-cost investment strategies for moving towards compliance with air and water quality standards in the most heavily-polluted areas; and (iv) design of a work program for a series of environmental audits of the main industrial polluters as part of their industrial restructuring programs.

Special features: No special risks; it is in fact a safeguard to facilitate coordination of prospective international assistance as well as to accelerate process of dealing effectively with this high priority issue.

3. Energy Resource Development ($250 m, 4Q FY90)

Objective: To reduce the projected decline in hard coal exports to convertible currency areas by enhancing operating efficiency in the natural gas and lignite subsectors, thereby increasing production of these hard coal substitutes. Increased and economic use of natural gas will contribute to a reduction of environmental pollution, an objective which will be further supported by appropriate energy price reform.

Special features: Lending mechanism not yet defined, but project expected to yield net foreign exchange earnings many multiples of foreign exchange costs. The project includes a direct environmental component through proposed investments in gas desulfurization plants. Technical assistance would be offered to enable Polish Oil and Gas Company to identify the areas most suitable for joint ventures and to build up capacity for negotiations in that field. There could be significant scope for cofinancing in these energy subsectors once World Bank lending has started and lending mechanisms are clarified.

4. Transport Project ($250m, 3Q FY90)

Objective: To support the implementation of improved policy programs in the transportation sector (such as closure of uneconomic railway lines and reduction/rationalization of subsidies), linked to improved macroeconomic management. Project investments would be directed to increase operational efficiency of the railways and highway administration, which have been neglected in the past and if not addressed would constitute a severe constraint on the effective functioning of the economy.

Special features: Lending mechanism not yet defined. First project in pipeline expected to be explicitly linked/conditioned on overall sectoral program, although project financing would continue to be directed at appraised investments activities. There is some scope for cofinancing by reducing World Bank share.

5. Energy Supply Restructuring ($250m, 3Q FY91)

Objective: To reduce projected decline in hard coal exports to convertible currency areas by enhancing operating efficiency of existing and future power and district heating systems by: (i) restructuring heat supply away from heat-only plants and towards combined heat-power production and (ii) rehabilitation and/or modernization of existing coal-fired power plants and transmission, distribution and load management in the power system and selected district heating networks.

Special features: Lending mechanism not yet defined, but net foreign exchange benefits expected to be significant. Project design is being carefully tailored to link with proposed Environmental Technical Assistance activities. Major environmental components include fluidized bed combustion and coal washeries components. The latter would result in improved ash disposal, while large amounts of washing residue could be sued by introduction of advanced coal slurry combustion technologies. Significant scope of cofinancing.

1989 ANNUAL MEETINGS BRIEF — POLAND

August 29, 1989

Meeting with: Mr. Zdzislaw Pakula, President, National Bank of Poland and World Bank Governor

Population: 37.8 m (1987); Estimated Growth Rate 0.8% (1980-85)
GNP per capita: $1850 (1988)

	($m)		($m)
Total Commitments to date:	none	FY89 Commitments:	none
Lending Program: FY90-91	$905		

Summary Data	Average 1984-88	1989	
GDP growth	3.9	1.7	IMF Status as of: 7/89
Conv. Curr. Acct Deficit (% GDP)	-1.0	-2.2	Art. IV: 9/89 mission
Conv. Curr. Export Growth	5.0 a/	10.0	
Conv. Curr. Import Growth	6.7 a/	12.0	
Gross Debt Service Ratio (Paid)	20.3 b/	25.0	No Standby or EFF yet
(Owed)	72.2 b/	61.8	
Annual Inflation Rate	28.3	130.0	

a/ Includes non-convertible b/ 1987-1988

Background:
1. Political: Moved rapidly towards greater democratization with new Parliament and formation of government headed by Solidarity with participation of Communists and minor parties. Completely new patterns of power-sharing will be evolving.
2. Economic: Deteriorating with slow growth and rising inflation; Government considering tough macroprogram; stabilization measures under discussion with IMF.
3. Bank Operations: Two loans ready to negotiate and solid pipeline.

Issues likely to be raised by delegation:
1. Scope and Timing of Bank Lending
2. Prospects for Brady Plan Support

Issues to be raised by Senior Management:
1. Medium-term Prospects for Implementing Reforms
2. Strategy for Dealing with Current Creditors and other Potential External Assistance

Attachments:

FIVE-YEAR LENDING PROGRAM: FY90-94 (FY89 actual)

Biographical Information

BACKGROUND

1. Despite steady growth throughout most of the 1980s and implementation of important economic and political reforms, the situation in Poland remains very difficult and the standard of living is virtually the same as it was 10 years ago. This fact has led to social malaise and has psychologically overshadowed some relatively good economic performance and bold reform measures. With reference to pre-crisis levels (late 1970s), GDP is still about 1% below, GDP per capita about 6% below, agricultural output and meat production about the same, annual numbers of apartments completed about one third less, and hard currency exports about 16% more but corresponding imports about one third less.

2. The political situation is changing rapidly; as this briefing is written, a Solidarity-led Government is being formed with participation of Communists and several minor parties. With such tremendous changes, some time will be required before senior appointments are completed and working relationships with staff (appointed under previous Communist governments) are established. Nevertheless, all signs are that government will want to move quickly to address economic problems; preparation and implementation of a stabilization/adjustment program is seen as the first priority of the new government.

3. While we have extended a PPF for $1.5 million and IFC has financed one project ($18 million), we have conditioned IBRD lending on the finalization and start of implementation of a credible medium program supported financially by the IMF, which would trigger Paris Club rescheduling--although some Paris Club members appear to consider moving to another rescheduling even with a Fund program--and establish Poland's future creditworthiness. Together with the Fund we have discussed such a medium-term program a number of times, most recently in July/August. The possible next opportunity is mid-September. The IMF is planning at that time a mission--which we would join--to do an Article IV consultation and resume discussion on a medium-term program. (We plan to send to the Poles a CEM around that time). This, however, will only be confirmed when the new Government indicates that the timing is convenient and may well slip to October. Other aid is materializing, though still in very small amounts. The EEC has pledged over $100 million in food aid following the August 1st meeting on Poland and Hungary; a further meeting is planned for October to discuss further aid; we will likely be invited to that meeting and may be involved in an aid-coordination role. The U.S. has pledged some $100 million to aid private enterprise, $15 million to improve the environment, and $50 million in agriculture products.

ISSUES

Part I: Issues Likely to be Raised by the Delegation

1. (a) Scope and Timing of World Bank lending: The Polish authorities will seek confirmation of when the Bank will initiate lending. Their concern is that two projects (Industrial Export Development and Agroindustries Export) appraised in December 1987 might disappear from the program. Pending the formulation of a medium-term program which the Fund and the Bank could support and which would thus serve as the trigger for the initiation of Bank lending, the National Bank of Poland has provided bridge financing to enterprises to

cover some downpayments to contractors involved in appraised subprojects. The bridge financing expires end-September and, although the projects have so far been kept alive, if Bank lending is not forthcoming in the near future, alternative financing sources will have to be found and the projects as appraised may not survive. The Poles have previously asked for a SAL, and this request may be repeated as Solidarity aid requests have also included a SAL.

(b) Recommended Position: You may wish to note the good progress already attained in developing sound macroeconomic and debt management plans, which are the key ingredients to determine Poland's creditworthiness for Bank lending. You may wish to reiterate our position, namely that the Bank intends to invite negotiations for the first two loans (about $300 m) after the basic ingredients of a stabilization program are agreed with the IMF and to present these loans to our Board for approval once the Standby is scheduled for IMF Board discussion. Because we are confident that this can happen soon, we sent a post-appraisal mission to Poland in early September to update the projects and the proposed lending arrangements and are planning to send another mission in October to resolve any outstanding issues prior to formal negotiations. Should the request for a SAL arise, you may wish to mention that we have a variety of lending instruments which could be developed to aid Poland's restructuring program, that we look forward to getting the lending program started, and that the precise content of the lending program (and its level in the future) would emerge after further consultation between the Bank and the authorities.

2. (a) Prospects for Brady Plan support: As part of their request for external support, the Polish authorities announced that they wish to be treated on the same conditions as any other country eligible for Brady Plan support and put the commercial banks on notice that they would no longer be given preference over Paris Club creditors. Although Poland had been paying full interest (and a small amount of principal) to the commercial banks since 1982, Poland received no new lending and its debt currently trades on the secondary market at about 40% of face value. The commercial banks hold about $9b of Poland's $39b debt, whereas Paris Club creditors hold about $26b, on which they have received almost no interest or principal since 1982. Most commercial banks have established large reserves against Polish exposure in response to regulatory and tax policies mandated by their respective governments. The commercial banks recently agreed to extend the term of a short-term trade facility to provide some cashflow relief, but the larger questions of debt relief/reduction have not been addressed.

(b) Recommended Position: You may wish to explain that the key to eligibility for Brady Plan support is the establishment of a viable macroeconomic plan. Once Poland completes agreement with the IMF and the Bank on such a program, we would be pleased to work with the Polish authorities to explore Brady Plan prospects, although our preliminary calculations indicate that the net benefits to Poland would be rather modest.

Part II: Issues to be Raised by Senior Management

1. (a) Medium-term prospects for Implementing Reforms: The stabilization program and the economic reforms are inextricably linked, for unless the macroeconomic environment enforces financial discipline, the institutions undergoing reforms cannot operate effectively and strong temptations would arise to revert to more direct forms of Government intervention to deal with the associated problems. An acceptable medium-term plan thus constitutes the focal point for future Bank/Fund assistance. The political and economic reforms are also linked, as the prospects for a successful stabilization rest mainly on their acceptability to the general population and the new political instruments provide even greater public influence on Government policy. Throughout the stabilization period, although it will be difficult to reach a political consensus, the Government must also sustain work on the design and implementation of further adjustments and systemic reforms which will bring results in the medium-term. The recent CEM looks at these issues and is scheduled to be discussed with the Government in October/November 1989.

(b) Recommended Position: You may wish to inquire about the Government's reading of the current domestic political situation and how that is affecting the Government's stabilization strategy. You may also wish to inquire how the Government intends to continue conceptual and organizational work to sustain the pace of systemic reforms.

2. (a) Strategy for Dealing with Current Creditors and Other Potential External Assistance: In a reversal of past experience, relations with the Paris Club are improving, but deteriorating with the London Club. This comes as the Polish authorities are attempting to elicit support from Paris Club members beyond the scope of the usual reschedulings (which in any case remain the key financial variable in Poland's recovery plans). Furthermore, the announcement of the Brady Plan caused the Poles to re-evaluate their good payment record to the banks which brought them no new lending and very limited short-term trade finance. The Soviet Union has also provided some relief on about half of the $3 billion owed by Poland, but current plans still call for Poland to pay back the Soviet Union faster than Paris Club creditors. Recent political developments have also opened the door for potentially large concessional assistance--commodities, technical assistance as well as various forms of finance. The Polish authorities do not have a viable mechanism for coordinating such assistance and run the serious risk of misusing or not getting the maximum benefits from the assistance now opening up to them.

(b) Recommended Position: You may wish to inquire about the Government's current strategy towards each major creditor group and their reading of what support can be elicited. You may also wish to inquire how they intend to marshall the potentially large concessional and financial assistance opening up to them and to offer World Bank assistance in this coordination effort.

Attachment I

POLAND

FY90-94 Lending Program
(in $ million)

	Actual FY89	FY90	FY91	FY92	FY93	FY94	Sector Total
Agriculture							
Agro-Industry		50					50
Livestock Feed				100			100
Agr. Unident.					100		100
Sub-total		50		100	100		250
Infrastructure							
Transport I			150				150
Transport II						100	100
Telecom I				200			200
Sub-total			150	200		100	450
Industry							
Ind. Export Devl.		250					250
Ind. Restr. I			200				200
Ind. Restr. II						200	200
SME Development					250		250
Sub-total		250	200		250	200	900
Energy							
Energy Res. Devl.			250				250
Energy Supply Restr.				200			200
Energy III						200	200
Sub-total			250	200		200	650
Other							
Fin. Inst. Devl.				100			100
Technology Devl.					100		100
Environment					50		50
Human Resources					50		50
Environment TA		5					5
Sub-total		5		100	200		305
Total		305	600	600	550	500	2555

August 29, 1989
EM4CO

BIOGRAPHICAL INFORMATION

Mr. Zdzislaw Pakula, President, National Bank of Poland
and World Bank Governor

Born on November 27, 1934 in Oszkowice. Married.

Graduated from Lodz University, Economic Faculty.

1952-1954	Teacher in the Primary School in Lodz
1954-1956	Instructor in the District Committee of the Polish United Workers' Party (PUWP) in Lodz
1956-1958	Teacher in the Primary School in Lodz
1958-1963	First Secretary of the Lodz Committee of the Socialist Youth Union
1963-1966	Director of the Enterprise of Trade in Chemicals and Household Commodities in Lodz
1966-1971	Director of the Voivoidship Branch of the Universal Savings Bank in Lodz
1971-1975	First Deputy and then General Manager, Universal Savings Bank in Warsaw
1975-1978	Director of Bank-Member of the Board of Management, National Bank of Poland
1978-1985	Vice President, National Bank of Poland
1985-1988	First Vice President, National Bank of Poland
1988-present	President, National Bank of Poland

Other Delegation members meeting Messrs. Conable/Qureshi:

Mr. Grzegorz Wojtowicz, Vice President, National Bank of Poland and Alternate World Bank Governor

Mr. Andrzej Scislowski, Director, World Bank Cooperation Bureau, National Bank of Poland

Mr. S. Jerzak, Director, Foreign Department, National Bank of Poland

Mr. Andrzej Ilczuk, Advisor, EDS

Ms. Anna Syska, Translator, National Bank of Poland

August 29, 1989
EM4CO

Poland

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/07/25 DUE DATE : 00/00/00
LOG NUMBER : 890725013 FROM : Mr. Stoujesdijk
SUBJECT : Poland - visit of US Undersecretary of State, Mr. McCormick. on Thursday, July 27, 1989 at 12:30 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

- ______ APPROVED
- ______ PLEASE HANDLE
- ✓ FOR YOUR INFORMATION
- ______ FOR YOUR REVIEW AND RECOMMENDATION
- ______ FOR THE FILES
- ______ PLEASE DISCUSS WITH ______
- ______ PLEASE PREPARE RESPONSE FOR ______ SIGNATURE
- ______ AS WE DISCUSSED
- ______ RETURN TO ______

COMMENTS :cc: Mr. Stern, JWS

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 25, 1989

TO: Mr. Barber B. Conable, President

THROUGH: Mr. Attila Karaosmanoglu, Acting Senior Vice President, SVPOP AK

FROM: Everardus J. Stoutjesdijk, Acting Vice President, EMN EJS

EXTENSION: 32707

SUBJECT: POLAND--Visit of US Undersecretary of State

1. You will meet with Mr. Richard McCormick, US Undersecretary of State on Thursday, July 27 at 12:30pm. We understand that he wishes to discuss prospects for World Bank support to Poland in the context of the Group of Seven initiative announced earlier this month. Ms. Loos, Acting Chief EM4CO, and I will also attend.

2. In your discussions with Mr. McCormick, you may wish to:

(i) review the outlines of the World Bank strategy, which is based on the widely recognized need for a viable macroeconomic envelope to guide the reforming economic system; and

(ii) acknowledge the importance to Poland's recovery plans of the renewed interest and support by official creditors, as they will continue to be the major external financial variable through rescheduling of existing debt.

3. As background for the meeting, this memo outlines the latest developments in Poland, our understanding of the current state of play in relations with current creditors and the IMF, and the World Bank strategy.

Recent Developments in Poland

4. Political developments are moving rapidly towards greater democratization, but economic conditions are deteriorating. During the past year major ideological barriers were broken and roundtable talks between Communist Party and opposition forces established a basis for further

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cleared with and cc: Mr. Ramsubbu
cc: Messrs. Thalwitz (o/r), Hasan (o/r), Lari (o/r), Nouvel (o/r)
Lav (o/r)

JLoos

political reforms, leading to legalization of Solidarity, free elections for a significant share of the new two-house Parliament, and election of a President with expanded executive powers. Important institutional reforms were also implemented, e.g., establishing equal treatment for socialized, cooperative and private sector operations, improved joint venture laws, increased access to foreign currency at market-determined rates, etc.

5. During these tumultuous times, macroeconomic management was neglected and by late 1988 the economy was seriously overheated. The outlook for 1989 is even worse as overall growth and exports slowed, excess demand continues to exacerbate market imbalances and there are widespread shortages. While some remedial measures were introduced to improve exports, these will not make up for the losses already incurred and the current account deficit is expected to widen to nearly $1b.

6. A new government is likely to be formed in the next few days, and there is intense speculation about what role the opposition forces will play. The key issue facing the government will be macroeconomic management. While most people recognize that there needs to be a major stabilization as well as adjustment to enable the reforming economic system to operate with increasing efficiency, the roundtable accords did not establish a concensus on how to handle this difficult situation and there are disparate factions within the Communist Party group and the opposition with widely differing views.

Relations with Creditors

7. Relations with Paris Club creditors, which hold about $26b of Poland's total $39b foreign debt, continue to improve in political terms, but this has not yet been translated into agreed rescheduling terms. The latest Paris Club meeting last week renewed the call for greater support for Poland, but most members were very cautious about moving very far without a viable economic and reform plan in place. Poland is in default of its obligations under the last Paris Club rescheduling covering payments due 1986-88, and there are no arrangements in place to handle payments due in 1989. The simple arithmetic is that Poland owes interest of about $3.5b per year but has a trade surplus of only about $1b and transfers/remittances of about $1-1.5b. Until recently, Poland used these resources to pay interest to the commercial banks (about $1b) and to increase reserves against the large private holdings of foreign deposits in the banking system, leaving little or nothing for official creditors. Current amortization schedules on Paris Club debt call for additional payments of about $2b per year in the 1990s.

8. Relations with London Club creditors, which hold about $9b, had been normalized under a multiyear rescheduling agreement through 1993--with Poland paying full interest and a minor amount of principal--but Poland recently requested further relief through lower interest rates as well as to be treated no worse than others being considered for Brady Plan assistance. In the meantime, the commercial banks extended the term of Poland's short-term trade facility to provide some cash flow relief through November 1989, but have not yet addressed the fundamental issue of further debt relief/reduction.

9. President Bush announced a program of US support for Poland, concentrating on assistance for private sector joint ventures and environmental matters, amounting to about $115m. Various parts of the US government have contacted the Bank to learn more about our work and discuss prospects in Poland, but their programs are not yet very well defined. Prospects for West German support also remain unclear, although there are advanced discussions about converting a DM1b loan into local currency to be used on agriculture, environment and cultural matters. It appears the Kohl government is hesitating to appear too forthcoming on Poland for fear of aggravating right-wing resistance. The long-awaited Kohl visit is still not scheduled.

10. The Group of Seven requested the European Community (EC) to organize a meeting of interested Western governments to attempt to coordinate bilateral support to Poland. This was brought up in the context of a discussion of food aid, but the exact terms of reference remain unclear. The meeting is set for August 1 in Brussels, and while EC staff are consulting with the Bank and the IMF, we have not been invited to attend.

11. The Polish authorities presented outlines of a revised macroeconomic stabilization plan to the IMF and the Bank earlier this month. While we found flaws, the general consensus is that, unlike previous efforts, this latest plan does present something substantial and may lead to an IMF Standby. The timing for such negotiations is not clear, as the political environment remains fluid. Assuming a new government is formed soon, it works within the general framework as discussed with the IMF, and the new Parliament supports such moves, there is a chance that the IMF Article IV consultation now scheduled for September could move into full Standby negotiations. We understand the IMF is currently thinking in terms of a 12-18 month program, possibly followed by an EFF. The prospects for such a scenario are far from certain, as the required stabilization will be painful and the political consensus for such remedies is far from assured.

World Bank Strategy

12. Our agreed startup strategy is to continue working with the Polish authorities to assist in the preparation of viable macroeconomic and debt management plans, and to inititate lending once these plans are satisfactory and there are firm assurances that adequate support will also come from current creditors and the IMF. While we may choose to channel our lending in the first round through investment vehicles, the larger macroeconomic management and systemic issues are the focus of our work. World Bank lending alone would be neither effective nor sufficient, as the reforming economic system cannot operate without a viable macroeconomic framework and the regularization of relations with official creditors is the key external financial variable in these plans. We are working closely with the Polish authorities and the IMF on such plans.

13. In addition to our strong program of economic and sector work, we prepared and have ready a number of investment projects to finance activities which generate significant net foreign exchange earnings in a short period of time (Industrial Export Development and Agroindustrial Export Development

projects) to assist in Poland's efforts to enhance its creditworthiness through expanded exports. We also have identified a small environmental technical assistance program which we hope to move quickly to develop strategies and approaches for appropriate investments to be financed subsequently by many other sources as well. For the medium-term, we have also identified and begun preparing investment projects in the energy, environment, transportation and agriculture sectors to assist with the needed restructuring of these sectors.

14. There is also a good prospect for moving into policy-based loans in the medium-term, to support important systemic and policy reforms as well as to provide vehicles to facilitate potential Brady Plan initiatives. Foreign trade and financial sector reforms are two areas which may be suitable for this type of support.

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

~~MH~~
6/28
4:30

CORRESPONDENCE DATE : 89/06/27 DUE DATE : 00/00/00
LOG NUMBER : 890628001 FROM : Mr. Nassim (SWR)
SUBJECT : BRIEFING: meeting with Mr. Larson, Polish Amb. Economic Council
on Wedenesday, June 28, 1989 at 4:30 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
__✓__ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :cc: Mrs. Haug

DATE: June 26, 1989

TO: Mr. William Ryrie

FROM: Edward Nassim

EXTENSION: 30575

SUBJECT: POLAND: IFC Operations

Mr. Conable

1. Poland joined IFC in December 1987, since when IFC has spent time in learning about the economy, developing its business contacts and building a pipeline of projects. IFC took its first investment to Board in November 1988, a US$17.9 million loan to the cooperative enterprise, Hortex, to help increase exports of horticultural products.

2. IFC's policy regarding Poland is to assist in export-oriented projects, located in the private sector, that make both commercial and economic sense. IFC is only supporting those projects that are robust enough to survive in Poland's present difficult economic climate and are not predicated on policy-oriented change.

3. Following the introduction of the new Foreign Investment Law (a law which IFC advised on), IFC is working on the first generation of major joint ventures between international companies and Polish enterprises. IFC's role involves the financial structuring of such projects, both utilising its own funds and also mobilising the funds of commercial banks. IFC is also acting in an advisory capacity to the joint venture partners - helping the foreign partner understand the investment framework in Poland, and providing independent advice to the local partner on the proposed terms of the joint venture cooperation. This follows the pattern of IFC's activities in Hungary.

4. IFC is seeking to promote the growth of the small indigenous private sector in a number of ways. The private sector can only expand if it has access to foreign exchange for investment. IFC will try to provide support initially by channelling funds through local financial institutions, and then by helping to create new private sector banks.

5. Finally, IFC will continue to work with the cooperative sector in those projects that have a direct impact on increasing Poland's exports.

<u>Annex - IFC's Current Activities</u>

1. Below is a summary outline of IFC's current activities.

<u>Existing Investment</u>

2. <u>Hortex</u>: IFC Board approved its first investment to Poland last November, a US$17.9 million loan to the horticultural cooperative, Hortex, to help it expand its exports of frozen fruit and vegetables. Implementation of the project, scheduled to take two years, is going well, and to date IFC has disbursed 26% of its loan.

<u>Future Investments</u>

3. <u>Bristol Hotel</u>: IFC has four projects in a reasonably well-advanced stage. The first that is likely to proceed to Board is a privatisation of Poland's most famous hotel, the Bristol. This will be implemented under Poland's new joint venture law and will involve the UK hotel group, Trusthouse Forte. Because of the national significance of the hotel, the privatisation arrangements are receiving a lot of positive public attention in Poland. The Joint Venture Agreement between the foreign and local partners was signed on June 10 in London and preparation of financing arrangements is well under way. IFC involvement is US$8.7 million and presentation to IFC Board is expected in August/September.

4. <u>Agency Credit Line for the private sector</u>: The second project is an agency line for the private sector, including cooperatives and joint ventures. The project will involve IFC in providing technical advice to the relevant Polish financial institution (Export Development Bank), and will help promote the growth of export-oriented private sector firms and cooperatives. IFC investment is likely to be US$25 million and the project could be ready for IFC Board submission by October/November.

5. <u>Europejski Hotel</u>: The third possibility is another hotel privatisation. This would be a joint venture scheme involving a group of private US investors and the Kempinski group of Federal Republic of Germany. IFC investment is likely to be US$10.0. This project has some uncertainties at this point. In any event it is unlikely to be ready before early next year.

6. <u>Float Glass Project</u>: IFC is considering a major industrial joint venture to establish float glass production. The scheme involves the Japanese companies, Asahi Glass and Toya Menka. Preparation of the project is proceeding, but because of the scale of the project and the many technical, legal and financial issues involved, its timing is uncertain but could be a year or so from now. IFC involvement is in the order of US$43.0 million.

7. Obviously, one or more of these could fall away for the usual reasons (foreign partner's change of mind, market shifts etc). In addition to the four concrete proposals IFC is also hoping to provide assistance in the restructing of the financial sector in Poland, and to help in the creation of one or more joint venture private sector banks.

LARAMCO
Lincoln Plaza
Two Lincoln Highway
Edison, NJ 08820
(201) 906-2424

June 23, 1989

Barber B. Conable, Jr., President
World Bank
1818 H Street, N.W.
Washington, D.C. 20433

Dear Barber:

I talked to Linda and would like very much to see you next week in Washington. I will keep Tuesday and Wednesday open for this possibility.

I have just returned from Poland as a member of the Polish/American Economic Council-Agri-business committee.

Enclosed is a recent article from our New Jersey Star Ledger indicating some views.

We are all excited about President Bush's incentives and initiatives for Poland. I am sure the Poles are aware that the "give-away" programs are over.

Looking forward to seeing you.

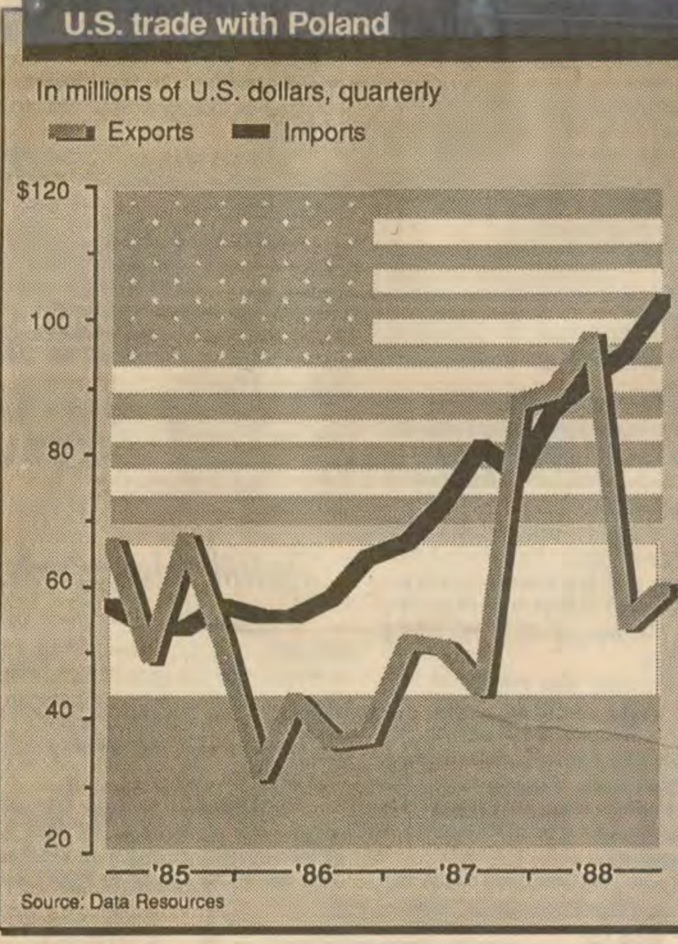
With warm regards,

Robert

Robert W. Larson

RWL:gcg
Enclosure

The Star-Ledger
BUSINESS
WEDNESDAY, JUNE 14, 1989



"There is a great move now in Poland to liberalize their laws, creating opportunity for those in Poland and outsiders who want to invest."

— **Robert W. Larson,** member of the Polish-U.S. Economic Council

Star-Ledger/L.H. MARBURGER

DOOR OPENING

Execs find more opportunity in Poland

By JUDITH A. OSBORNE

Changing political conditions in Poland and an easing of certain business venture restraints means increased opportunity for American firms to seek joint ventures with Polish firms, according to a member of the Polish-U.S. Economic Council.

Robert W. Larson, chairman emeritus of Cenlar Federal Savings, has been a member of the council for two years. A group of about 60 business executives traveled to Warsaw last month with the council, an organization seeking to develop stronger trade relations between Poland and the U.S. and to expand industry through joint ventures.

"There is a great move now in Poland to liberalize their laws . . . creating opportunity for those in Poland and outsiders who want to invest," Larson said.

Modified laws in Poland have also shortened a lengthy application process for foreign entities looking to establish joint ventures in Poland, invest in an existing Polish firm or to set up their own companies there, he said.

Much of the new business will emerge in the area of agri-business, according to Larson, who pointed out that large quantities of ham and vodka are already exported by Poland while other opportunities will surface in the areas of textiles and furniture production.

He noted that lower wages and costs of raw materials in Poland have served as an attraction for larger foreign investors in Poland, but noted that revisions in laws may encourage smaller companies to look to Poland as well.

"Poland seems to be moving faster (in its revisions) than other eastern block nations," according to Larson, who contends that Polish companies readily seek ties with American firms, even faster than with European entities.

"They are more familiar with the American customs because many have relatives here," he said.

He said there are currently about 150 companies in Poland that have applied to the Polish Chamber of Commerce seeking American joint venture opportunities or investment by U.S. companies.

Ming Hsu, head of the state Division of International Trade warns however that an easing of restrictions does not mean a complete turnaround in that country's policies and that "we should not become overly optimistic."

"With the development along the political lines in Poland there will be an easing of restrictions," she said, but noted that rapid or immediate growth does not seem likely even though Poland needs American "technology, expertise and capital investment."

"In most cases there is still a lot of reviewing that has to be done on a case by case basis which makes it difficult for our companies," Hsu explained.

Restraints imposed both here and abroad has made and continues to "make it difficult for our companies to conduct business with foreign companies."

Larson noted that President Bush has proposed a number of initiatives towards Poland which would support business relations in the future. Authorization is

Please turn to Page 45

Poland's door opening

Continued from Page 43

expected to be sought for the Overseas Private Investment Corp. (OPIC) to implement programs supporting companies interested in investing in Poland.

If authorized OPIC would be able to provide political risk insurance against political strife or currency inconvertibility, for example, and to offer direct loans of up to $6 million to smaller businesses and up to $50 million to larger operations interested in developing business relations in Poland.

Larson first became involved in Polish business 14 years ago when he accompanied an architect planning to construct a highrise there. Larson, who arranged financing for the venture, said he was then able to establish contacts with many of the Polish business executives.

He said a number of large foreign firms had operations in Poland prior to the establishment of military law, firms that withdrew their investments when heavily restrictive policies were enforced.

U.S. imports from Poland reached $417 million last year from $330 million in 1987, according to the Department of Commerce.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: June 14, 1989

TO: Mr. Adil Kanaan, Acting Division Chief, EM4CO

FROM: Michael R. Lav, Sr. Economist, EM4CO

EXTENSION: 32556

SUBJECT: Poland - Back-to-Office Report

1. **Mr. Saldanha and I visited Poland from June 4 to June 10 in conjunction with an IMF staff visit. The mission met with National Bank President Pakula, Finance Minister Wroblewski, and others. In brief, we found that government was so concerned about the outcome of stage I of the elections for the parliament (and the implications for the composition of the cabinet) that it was not able to discuss macro-economic management for the second half of 1989, much less medium term strategies, even at the technical level. Therefore, it was agreed that the IMF would return for Article IV consultations in September, and that Government would inform when further discussions on macro-economic management and a possible stand-by arrangement would be convenient.**

Elections

2. The first round of the elections was held on June 4th. The strong showing of the opposition came as something of a surprise to government. With 62.7% of eligible voters participating, 92 of 100 seats in the new Senate and 165 of 460 seats in the Sejm were decided, with the remainder requiring a runoff election to be held June 18. Concerning those races decided in the first round, the opposition won all 92 of the senate seats (and appears likely to win 7 of the remaining 8 seats during the runoff). For the Sejm, 2 out of the 35 running on the national

cc: **Messrs./Mmes.** Hasan, Michalopoulos (EMNVP); Lari (o/r), Harrison, Zaidan (EM4) Nouvel (o/r), Milanovic, Loos (o/r), Chutikamoltham, Hilton, Hinayon (EM4CO), Sood, Cordet-Dupouy, Reyes-Vidal, Busz, Craig (EM4IE), Apitz, Vasur, Hayden (EM4IN); Ramasubbu, Ablasser, Brook (EM4AG); Harbison, Schweitzer, Boissiere (EMTPH); Hinds, Saldanha, Tarr, Manes (EMTTF) Thumm (EAS); Gustafson, Nassim, Doran (CEM) Prust, Hole (IMF)

Lav/mct

list were elected.[1] The remaining 33 who lost, including Prime Minister Rakowski, Interior Minister Kiszczek (who had chaired government's side during the Round Table), and Professor Baka, will apparently not further participate in the election process although no clear rules had been established to address this possibility. The remaining seats in the Sejm are allocated by the Round Table Agreement between the government coalition and the opposition. Of the 163 who were elected to the Sejm in the voting by district, 160 are from the opposition, 1 from the PUWP (Communist Party), and 2 from the small United Peasants Party allied with the PUWP (while the small Democratic Party also allied with the PUWP did not win any seats). The second round will be structured in accordance with the Round Table agreement so that the PUWP and its allies will be assured of 267 seats. It is not clear how the 33 remaining seats from the national list to which the PUWP coalition is also entitled will be filled, since those on the original list have declined to run again even if this had been formally proposed; the opposition has said that they were allocated to the PUWP coalition during the Round Table and should be filled by any method satisfactory to the PUWP.

3. In view of these results, the considerable uncertainty surrounding the composition of government and any possible role of current cabinet ministers, government's reticence to discuss macro-economic management in concrete terms is quite understandable.

Government's Presentation to the Mission

4. Government presented the mission with a paper entitled "Assumptions for a Medium Term Economic Policy".[2] The paper begins with the following: (a) priority should be given to attaining internal equilibrium, for which the main task is increasing the efficiency of the economy, (b) sound financial discipline is indispensable, and (c) liberalization needs to be pursued (reduction of central controls and administered prices, introduction of capital and foreign exchange markets, etc.). The paper outlines an impressive list of measures to be taken and as a general guide these seem to be in the right direction. However, the program lacks specificity, and this comes out clearly in the section on implementation. Thus, during stage I (there are three stages), the important actions are:

(i) taking decisions on closing down the most material and energy consuming enterprises (note that this is an administrative action rather than a market-related action);

(ii) reassess stock of capital in enterprises to facilitate conversion to joint ventures;

(iii) conclude legislative work on bankruptcy law;

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[1] Of these 2, neither is a member of the PUWP. One is an author of a widely read book on sociology, the other was a Mr. Zielinski, the last person on the alphabetically arranged list. Votes against the national list candidates were registered by crossing names off; the widely held assumption is that the lucky Mr. Zielinski succeeded because some cross-offs did not reach down to the bottom of the list.

[2] Copies available from my office.

(iv) adjust system of social benefits to future conditions of market economy, and;

(v) issue treasury bills.

It was also emphasized that government intended to eliminate price controls in the agricultural sector, both for inputs and outputs, from July (it is not clear how the election results will impact on this decision). While for stage two, the abolition of administrative prices in all other sectors is proposed, the paper clearly lacks a comprehensive framework.

The Economy

5. The economy continues to deteriorate. Inflation continues at 8 or 9% per month. Nominal interest rates remain at a base rate of 44% per year, with many rates below this because of discounts on credits and lower rates for deposits of less than two years.[3] Because nominal interest rates are so much less than the rate of inflation, rapid continuing expansion of the money supply is virtually assured. The budget deficit is worsening. Among the important factors increasing the deficit, are the increase in agricultural procurement prices by 34% in April with no offsetting increase in sales prices. While government would (or could) not revise its 1989 budget deficit estimate of 1 trillion Zloty, mission estimates suggested that a deficit on the order of 3 to 4 trillion Zloty was now quite possible. This would be equivalent to about 5% of GDP, up from the levels of 1% or so of the recent past. The current account deficit of the balance of payments could well increase from last year's deficit of $585 million, to something in the range of $1 billion to $1.5 billion. While export growth was interrupted this winter as exchange rate adjustments fell behind inflation, this has now been corrected and exports are increasing at a reasonable pace. However, imports have been substantially increased (apparently in connection with the elections since most of the increase comprised centrally imported consumer goods), while floating interest rates on external debt are also up. The resulting shortages of foreign exchange have motivated government to strike a new deal with the commercial banks (see para. 7 below).

6. The foreign exchange shortages have also unfortunately caused a reduction in the amounts of foreign exchange allocated to the Bank Handlowy auctions. The latter, begun in April, were to receive about $1.5 billion but may well receive much less. To try to protect the quantities of foreign exchange allocated to the auction, government may decide to reduce the amount of foreign exchange which may be retained by exporters (which now averages about 30%), with the resulting increase in foreign exchange obtained by government allocated to the auction. This was justified by the fact that exporters are keeping large amounts of foreign exchange on deposit at the banks, so that government feels that these balances are inactive and an unjustified use of resources. The mission pointed out that exporters were probably shifting their assets from Zloty deposits with very large negative real interest rates to dollar deposits with positive real interest rates,

[3] There is a small private sector curb market in which the interest rate, referred to as the Lombard Rate, has recently been at about 150% per year, which seems reasonable in view of inflation.

and the way to address the problem was to make Zloty deposits more attractive. Reducing the ROD rates would also dampen exports, possibly entice the government to further increase centrally allocated imports, and increase the degree of protection afforded the domestic economy. The latter follows from the fact that Bank Handlowy auction proceeds can only be used for imports of intermediates specified by government and not for imports of final goods.

External Debt

7. Progress continues to be made on signing the bilateral agreements needed to implement the 1987 umbrella agreement which would regularize 1988 interest obligations. The Finance Ministry informed that as of June 5, agreements have been signed with Austria and Italy, and initialled with Sweden, Finland, the United Kingdom, Switzerland, and France. Discussions were in an advanced stage concerning agreements with Canada, the U.S.(final approval was being awaited with the expectation that the ambassador in Warsaw would be able to sign the agreement shortly), Spain, and Japan. Concerning the Federal Republic of Germany, an agreement had apparently been reached but signing was postponed to tie in with other agreements and perhaps the forthcoming visit of Mr. Kohl. Discussions were in progress with Belgium and Brazil, while work on agreements with Holland, Norway, and Denmark was being left for the future.

8. On the last day of the mission, we were informed that agreement had been reached with the commercial banks,[4] under which amortization payments which had been due in 1989 ($150 million including $24 million which had been due but not paid in April) would be rolled over, while a portion of interest due would be accommodated by increasing the short-term import financing facility. I shall be discussing with the banks in the next few days to obtain details.

Next Steps

9. Government will inform when a mission would be appropriate. At latest, the IMF will visit Poland in September for the Article IV consultations while the timing of StandBy discussions is essentially up to government. At the end of the mission, I discussed next steps with Mr. Wojtowicz and Mr. Scislowski of the National Bank of Poland, and agreed that we would flexibly respond as soon as government indicated that further discussions would be useful. Reviewing the forthcoming CEM would be an important opportunity to pursue the dialogue.

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[4] Recall that the London Club agreement of last summer calling for payment of all interest (at 13/16 over Libor) and some amortization was being fully implemented until Poland notified the banks on April 21 that the amortization payment then due would not be forthcoming.

Record Removal Notice

File Title	Barcode No.
Poland - Country Files - Correspondence - Volume 1	1779845

Document Date	Document Type
June 19, 1989	Memorandum

Correspondents / Participants
From: Michael R. Lav, Senior Economist, EM4CO
To: Mr. Philippe Nouvel, Division Chief, EM4CO

Subject / Title
Poland Addendum to June 14, 1989, BTO

Exception(s)
Information Provided by Member Countries or Third Parties in Confidence

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

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Ann May	September 28, 2015

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 12, 1989

TO: Memorandum for the Record

FROM: Philippe Nouvel, Division Chief, EM4CO

EXTENSION: 32550

SUBJECT: POLAND - Meeting of Mr. Conable with HE Wroblewski, Minister of Finance, Washington, D. C., May 9, 1989

Attendance

Poland:	The World Bank:
HE Wroblewski	Mr. Conable
Mr. Wojtowicz	Mr. Qureshi, OPNSV
Mr. Czulno	Mr. Thalwitz, EMNVP
Mr. Krowacki	Mr. Lari, EM4DR
Mr. Ilczuk	Mr. Nouvel, EM4CO
	Mr. Draghi, EDS

1. Welcoming the Minister, Mr. Conable noted his interest in developments in Eastern and Central Europe, and particularly in Poland, where rapid reform movements were taking place.

2. Mr. Wroblewski stressed the very good relationship between the Bank and Poland, the appreciation Polish authorities had of the Bank's work, and the benefits Poland had drawn from the Bank's advice. Historical developments were indeed happening in Poland, with the start of a democratization process and moves towards pluralism, which should be strengthened over the next three to four years. On the economic front, there was a consensus to move Poland towards a full market economy. Private sector involvement was

Cleared with & cc: Mr. Lari (EM4DR)

cc: Mr. Conable's Office

Messrs/Mmes Qureshi (OPNSV)
Stern (FINSV)
Thalwitz, Hasan, El Maaroufi, Michalopoulos (EMNVP)
Zaidan, Harrison, Apitz, Ramasubbu, Sood, Loos (o/r), Lav, Milanovic, Chutikamoltham, Hilton (EM4); Harbison (EMTPH)
Gustafson (CEMDR)

PNouvel:mh/mct
2000G

encouraged and should take an increasing share of economic activity. IFC support and cooperation in that respect was much appreciated. Economic restructuring was a high priority, and for that purpose, development of a capital market was essential, to allow reprivatization of a large segment of the economy, and Poland much appreciated the assistance of the Bank in that area. Equally essential was the implementation of policies regarding price liberalization and exchange rate management, to introduce efficiency, competition, and competitiveness in the economy. The Government realized the importance of developing soon an adjustment program incorporating the above elements, inter alia, and was starting work on that program. The authorities hoped to finalize it by end of June, so that the Government coming out of the forthcoming elections would have a clear set of policies, and a program of implementation, to present to the Polish population and to the external creditors. The Minister was keen on getting technical assistance from the Bank to elaborate this program.

3. Mr. Conable said the Bank was anxious to help Poland prepare this program. He observed that Poland had difficult problems to solve, including on the external side the evolving relationship with its current creditors, and most specifically the Paris and London Clubs. Establishing through an adequate program Poland's creditworthiness was essential to allow external support to come in. In particular, the Bank had had projects ready for negotiations for about a year, and the faster this program would be prepared and found adequate by the Bank and the IMF, the quicker the Bank could be ready to move these projects through. The Bank was keen on working closely with Poland to prepare carefully the steps leading to Poland's creditworthiness. Of course, the program would have to be supported by the Polish people, and that might be difficult given the social pressures. Poland also had to regularize its relations with the Paris Club, which were a precondition to mobilizing the substantive external resources that Poland needed badly and quickly.

4. Mr. Wroblewski agreed that indeed the program needed to be backed by a social consensus. In that respect a major problem faced by the Polish authorities was how to control inflation, which was creating serious social problems. As regarded external support, Poland was determined to regularize its relationship with the Paris Club, and had started to do it. Poland was now enjoying sympathetic support from a number of countries, as evidenced in particular by President Bush's recent speech, and hoped this would allow it to improve its debt management, and in particular take advantage of the opportunities offered by the Brady Plan. Poland, however, realized that a credible program of restructuring and adjustment was key to getting adequate external support, and was firmly determined to prepare and implement it, to open Poland's economy to the rest of the world. It was a difficult task, particularly because of the social costs associated with such a program, which once implemented would result in a drastic change from Poland's past social policy. (Later in the discussion, Mr. Lari confirmed that the Bank had initiated discussions to provide assistance to the Polish authorities to help them address this problem.)

5. Mr. Qureshi, noting how crucial effective external debt management was for the implementation of an adjustment program, inquired about Poland's strategy vis-à-vis the Paris and London Clubs. Assuming external support would be forthcoming, Poland still faced a short-term problem of external liquidity, which made very delicate the handling of the relationship with current creditors during that period.

6. Mr. Wroblewski agreed, and explained that, while Poland was in the process of regularizing its situation vis-à-vis the Paris Club and settling the arrears, its available net external resources did not allow it to do so completely. He still was optimistic that all bilateral agreements under the 1987 rescheduling agreement would be signed by the end of June. The situation vis-à-vis the London Club was more complex. Poland had been advised by the Paris Club that it should observe an equality of treatment between public and private creditors. While its relationships with the London Club were correct and the rescheduling agreement with commercial banks had been implemented regularly, Poland now realized that it needed to tackle this question of equality of treatment, particularly given the severe external constraint it was facing at present. Therefore Poland had recently withheld payments on principal to commercial banks, and was starting new discussions with the London Club this week aimed at obtaining concessions on both financial and interest payments. However, Poland was entering the discussions with a very open mind. Mr. Wroblewski again stressed that, while finalization of arrangements with the Paris and London Clubs was needed, there was no way Poland would be able to implement its adjustment program without adequate external support, with the Bank and IMF providing an essential catalytic function in that respect.

7. Mr. Thalwitz observed that Poland, over the past eight years, had invested in the maintenance of a relationship with the London Club which had evident advantages, in particular the short-term facility provided by the commercial banks. While new flows from the Bank, IMF and others would be needed to support Poland's program, it was also necessary to handle the relationship with the Paris and London Clubs, particularly during the next few months when there was a liquidity problem, in such a way that the fruits of this steady relationship with commercial banks not be lost.

8. Mr. Qureshi agreed with Mr. Thalwitz and observed the issue was a tactical one. Agreements from the Bank and the IMF to Poland's adjustment program were critical, as included in that program would be financial projections demonstrating the amount of external resources that Poland could reasonably devote to debt servicing, in addition to the amount of new resources necessary to implement the program. Poland could then use these projections in its negotiations with the commercial banks, but should be careful not to jeopardize its investment with commercial banks until agreement on the program was reached.

9. Concluding the meeting, Mr. Conable recognized that Poland faced difficult issues, including the careful handling of current discussions with the Paris and London Clubs. He emphasized that the preparation and

finalization of an adequate adjustment program was urgent and essential to facilitate these discussions, and pave the way for external support either from current creditors, or from new sources, including the Bank and the IMF. Enlisting the support of the IMF for that purpose was essential. The Bank was anxious to be helpful in that matter, and was keen on working closely with the Polish authorities to prepare this program. The IFC, on its side, was actively preparing several projects for financing--four had been identified--and was therefore in a position to contribute to the implementation of Poland's reform efforts.

Record Removal Notice

File Title	Barcode No.
Poland - Country Files - Correspondence - Volume 1	1779845

Document Date	Document Type
May 12, 1989	Letter

Correspondents / Participants
From: President Barber Conable
To: Mr. Zdizislaw Pakula, President National Bank of Poland

Subject / Title
Appointment of Governor of the World Bank.

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information. This Policy can be found on the World Bank Access to Information website.

Withdrawn by	Date
Ann May	September 28, 2015

file

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/05/09 DUE DATE : 00/00/00
LOG NUMBER : 890509009 FROM : Mr. Thalwitz (MAQ)
SUBJECT : Briefing: Poland - visit of Minister of Finance Wroblewski
Supplementary briefing for today's meeting, May 9 at 6:30 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

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COMMENTS :cc: Mrs. Haug

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 9, 1989

TO: Mr. Barber B. Conable, President

THROUGH: Mr. Moeen Qureshi, Senior Vice President, SVPOP

FROM: for Wilfried P. Thalwitz, Vice President, EMN

EXTENSION: 32676

SUBJECT: Poland - Visit of Minister of Finance Wroblewski
Supplementary Briefing

1. This memo updates my memo of May 5 on the basis of discussions held today with the Minister.

2. The Minister informed that the Polish government would prepare a stabilization/adjustment program which would be the basis of a policy statement following the formation of a new government after the June elections. Both our staff and IMF staff are asked to help prepare the program.

3. Government is trying to improve relations with the Paris Club. We understand that, to date, bilateral agreements (needed to implement the 1987 umbrella agreement covering interest due during 1988) have been signed or initialed with the U.S., U.K., France, and Austria.

4. Because of concerns over foreign exchange availability and debt service payments to be made to Paris Club members as bilateral agreements are signed, the government has told the commercial banks that it would not be able to meet amortization payments due this year as part of an agreement signed last summer, and may tell the banks in the next few days that it would not be able to make full payment of interest. (Poland has made full payments of interest to the banks during all of its difficulties during the 1980s.)

5. The Poles have considerable interest in the Brady Plan and its implications for Poland. The Minister may raise this topic with you and ask about the Bank's role under the Plan. We reiterated the essential importance of having a credible adjustment program.

6. In fact, throughout our meeting, I stressed the importance of preparing an appropriate stabilization/adjustment program as the most important requirement for any progress. I also warned against disrupting relations with the commercial banks at this time, and suggested that there could be mechanisms to solve the liquidity problem until funding from the IMF/IBRD, the Paris Club, and the London Club could be forthcoming on the basis of a stabilization/ adjustment program.

Cleared with & cc: Mr. Lari (EM4)

cc: Messrs. Hasan, Michalopoulos, El-Maaroufi (EMNVP), Zaidan, Harrison (EM4)
Nouvel, Ms. Loos (o/r)(EM4CO)

ML
MLav/mct

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/05/08 DUE DATE : 00/00/00
LOG NUMBER : 890508001 FROM : Mr. Gustafson (SWR)
SUBJECT : Poland: IFC Operations
Meeting for May 9, 1989 at 6:30 pm
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

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COMMENTS :cc: Mrs. Haug, JVolk

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 8, 1989

TO: Mr. Barber B. Conable

FROM: Douglas Gustafson (through William S. Ryrie) WSR.

EXTENSION: 30571

SUBJECT: POLAND: IFC Operations

1. I gather you may see a Polish delegation this week; below is a summary outline of IFC's current activities. We are moving carefully, in order to insure that the projects we consider will be commercially strong and foreign exchange earning even assuming there is no major improvement in the macro-economic climate. Were the latter to develop, with Bank support, we could accelerate efforts. Everything we are doing is squarely in the center of the current reforms directed to encouraging foreign and domestic private initiatives.

Existing Investment

2. Hortex: IFC Board approved its first investment to Poland last November, a US$17.9 million loan to the horticultural cooperative, Hortex, to help it expand its exports of frozen fruit and vegetables. Implementation of the project, scheduled to take two years, is going well, and to date IFC has disbursed 26% of its loan.

Future Investments

3. Bristol Hotel: IFC has four projects in a reasonably well-advanced stage. The first that is likely to proceed to Board is a privatisation of Poland's most famous hotel, the Bristol. This will be implemented under Poland's new joint venture law and will involve the UK hotel group, Trusthouse Forte. Because of the national significance of the hotel, the privatisation arrangements are receiving a lot of positive public attention in Poland. IFC involvement is US$8.7 million and presentation to IFC Board is not expected until the early part of FY90.

4. Agency Credit Line for the private sector: The second project is an agency line for the private sector, including cooperatives and joint ventures. The project will involve IFC in providing technical advice to the relevant Polish financial institution, and will help promote the growth of export-oriented private sector firms. IFC investment is likely to be US$25 million and the project could be ready for Board submission in the second quarter of FY90.

5. Europejski Hotel: The third possibility is another hotel privatisation. This would be a joint venture scheme involving a group of private US investors and the Kempinski group of Federal Republic of Germany. IFC investment is likely to be US$10 m. This project has some uncertainties at this point. In any event it would not come before the third quarter of FY90.

6. Float Glass Project: IFC is considering a major industrial joint venture to establish float glass production. The scheme involves the Japanese companies, Asahi Glass and Toya Menka. Preparation of the project is proceeding, but because of the scale of the project and the many technical, legal and financial issues involved, its timing is uncertain but could be a year or so from now. IFC involvement is in the order of US$43.0 million.

7. Obviously, one or more of these could fall away for the usual reasons (foreign partner's change of mind, market shifts etc). In addition to the four concrete proposals we are also hoping to provide assistance in the restructing of the financial sector in Poland, and to help in the creation of one or more joint venture private sector banks.

8. To date we have enjoyed excellent cooperation from the Polish authorities and are impressed with the dramatic reforms being made to open up the economy to private initiative.

cc: Mr. Parmar

ADoran/DGustafson:lb

5/9
6:30 pm

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/05/05 DUE DATE : 00/00/00
LOG NUMBER : 890509001 FROM : W. Thalwitz & M. Qureshi
SUBJECT : POLAND: Visit of Minister of Finance Wroblewski on Tuesday, May 9 at 6:30 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

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COMMENTS :M. Haug, BBC (original)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: May 5, 1989

TO: Mr. Barber B. Conable, President

THROUGH: Mr. Moeen Qureshi, Senior Vice President, SVPOP

FROM: Mr. Wilfried P. Thalwitz, Vice President, EMN

EXTENSION: 32676

SUBJECT: POLAND--Visit of Minister of Finance Wroblewski

1. The Minister will report to you on the Government's plans, and he is expected to ask you about the timing of prospective World Bank operations, and any linkages to IMF programs. We suggest that you reply that we appreciate the economic and social evolution in Poland and wish to support it, but need to evaluate the Government's plans to see if they establish a viable path of macroeconomic and debt management for Poland which would restore the country's creditworthiness.

2. You can assure the Minister that:

(i) we are prepared to continue working with his authorities to assist in the preparation of such plans, although the paternity is clearly theirs, as they will have to make the tough decisions about pace and tradeoffs; specifically, we need to agree on key macroeconomic and supply related policies, such as those related to effective demand management; appropriate decontrol of pricing; phased elimination of the remnants of central allocation of materials; financial discipline; active exchange rate management; and further improvements to the foreign trade regime;

(ii) we appraised and have ready several sound projects to finance activities which themselves generate significant foreign exchange earnings in a short period of time (Industrial Export Development and Agroindustrial Export Development projects), and we have identified and begun preparing other projects in the energy, environment, transportation and agriculture sectors; and

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Cleared with & cc: Mr. Lari (EM4)

cc: Messrs. Hasan, Michalopoulos, El-Maaroufi (EMNVP);
Zaidan, Harrison, Nouvel, Lav (EM4)

JLoos

(iii) lending for these first projects would be initiated once sound macroeconomic and debt management plans are in place and adequate support is also being arranged from other external sources (including regularizing relations with the Paris Club and advanced preparation of an IMF agreement).

3. EMENA Management will be meeting with the Minister on Tuesday morning, May 9, and we will provide a short supplementary briefing before your meeting with him now scheduled for 6:30 pm that day.

Background

4. The Visit. Minister of Finance Andrzej Wroblewski (pronounced rub-LEV-ski) will be visiting Washington during the week of May 8 and hopes to use his visit to Washington to:

(i) clarify the conditions, timing and linkages of possible support from the Bretton Woods institutions;

(ii) explore with US officials the content of Mr. Bush's proposals announced last month; and

(iii) discuss the prospects of Brady Plan support for Poland.

Meetings are being arranged at the US State Department on Monday, May 8, and with the US Treasury (Secretary Brady) and the IMF (Mr. Camdessus) on Wednesday, May 9. An additional feature may be the possibility of signing the 1985 and 1987 bilaterals with the US Government to complete formalities for previous Paris Club agreements.

5. Mr. Wroblewski will be accompanied by Mr. Grzegorz Wojtowicz, Director of the Foreign Department of the National Bank of Poland and World Bank Alternate Governor; Mr. Wladyslaw Czulno, Director of Ministry of Finance Department for Relations with International Agencies; Mr. Andrzej Ilczuk and Mr. K. Krowacki, Financial Counsellors at the Polish Embassy in Washington, and a translator--as the Minister does not speak English. Messrs. Thalwitz, Lari, and Nouvel will also attend.

6. Unless the Minister brings with him some basic outlines for the Government's macroeconomic and debt management plans, his visit will not break ~~into~~ new ground. Recent Bank and IMF missions have stressed the points made consistently by all levels in both organizations that the entry ticket to get access to financial support from Bretton Woods institutions is an adequate macroeconomic and debt management plan which shows how Poland plans to stabilize the economy, adjust and restore creditworthiness over time (including regularization of relations with the Paris Club.)

7. Economic Developments. While output and exports continued their upward trends, 1988 was a difficult year and the beginnings of 1989 show signs of possible further deterioration. Many sectors showed serious signs of overheating as increases in nominal wages far exceeded increases in output. Resulting excess demand exacerbated market imbalances and widespread shortages

occurred. Inflation accelerated to about 70% in 1988, and in early 1989, reached into the 100% range. The rate of export growth slowed considerably by the close of the year, and the deficit on the convertible currency current account increased to $580 million, compared to $417 million in 1987, but was still less than 1% of GDP.

8. The Government put into place important new laws providing a more conducive framework for freer economic activity. The new law on economic activity places cooperative and private sector operations on equal footing with the socialized sector, removing ceilings of the scale of private sector activity and equalizing tax treatment. The new joint venture law greatly improves provisions for foreign investment (Poland also joined MIGA). The new foreign exchange law allows for domestic free convertibility of the zloty by the private sector. The foreign trade regime has been improved to leave increasing amounts of foreign exchange with the enterprises that earn it and permit free sale of foreign exchange to other enterprises. A new foreign currency auction system will allow enterprises to purchase $1.5-2 billion to finance imports (equivalent to about one third current import levels).

9. Political Developments. There have also been major reforms in the political sphere. The Government reached out to the opposition through the round table discussions to try to establish a consensus on the future development of Poland. Agreements reached include union pluralism and the registration of Solidarity, introduction of a two-tiered parliament, increased role of opposition in parliament and freer elections. Also underway are revisions to the civil and judicial codes, which reduce the scope of possible intervention by government authorities. Currently under preparation are revisions to the authority and fund-raising capacities of regional and other local bodies. The round table was less specific on questions of economic management; domestic political support for implementation of the reforms and needed stabilization is far from certain.

10. Creditworthiness. Relations with the Paris Club (which holds about $26 billion of Poland's $39 billion debt) deteriorated during 1988, as Poland did not fulfill the terms of the December 1987 rescheduling agreement (covering 1986-1988, about $9 billion), balked at completing the underlying bilateral agreements unless granted more favorable interest rates and clear prospects for new lending, and did not make payments due in 1988 of about $550 million. Appropriately, Poland has now shifted strategies and informed the Paris Club that it intends to complete the bilateral negotiations by about end May 1989 without demands for further concessions and will clear the 1988 arrears.

11. While Poland's striking political reforms have improved significantly its political relations with the West, they have not altered evaluations of Poland's creditworthiness. The recent Paris Club tour d'horizon praised the political developments in Poland as well as the shift in Poland's negotiating strategy, but indicated that official creditors will offer no special concessions to Poland and encouraged further economic reforms as the basis for an IMF program, the mobilization of fresh resources from the World Bank and

export credit agencies, as well as further Paris Club reschedulings.[1] However, there is also some talk of a European initiative (probably under Franco-German aegis) to provide extraordinary financial assistance to Poland to facilitate its reforms.

12. Until very recently, Poland was implementing satisfactorily the London Club 1988-93 rescheduling covering nearly all Western commercial debt (about $8-9 billion), paying full interest and a small amount of principal. Shortly after the announcement of the Brady Initiative, the Polish authorities informed the commercial banks that they would not make the April 20 principal payment ($24 million), but would continue to pay interest. The objectives, strategy and tactics of such a move remain unclear.

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[1] Note that Poland will continue to require rescheduling of Paris Club maturities through the 1990s.

C. F.

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

January 4, 1988

Dear Mr. Ilczuk:

I just returned to the office today from a short holiday vacation and was delighted to find the bottles of Polish Wodka which you so thoughtfully sent to me. Mrs. Conable and I are looking forward to sampling it during the New Year.

It was very kind of you to think of me, and I send you sincere best wishes for 1988.

Sincerely,

Barber Conable

Andrzej Ilczuk, M.A.
Financial Attaché
Embassy of The Polish
People's Republic
2640 16th Street, N.W.
Washington, D.C. 20009

Room # 5, E Executive Dining Room

Doug Coe

Mr. Morawski

Mr. Konzieweski (son-in-law, interpreter)

Mr. Lari

Gil McDowell (US Contact for the Polish visitors)

703 2473847
SEP-07-1988 16:47 FROM Fellowship Foundation TO 94771315 P.01

TO: JENNIFER VOLK

JWS 9/13

Kazimierz Bazyli MORAWSKI
Member of the Council of State

Born June 6, 1929, Mała Wieś. Educated in Academy of Political Sciences (Warsaw) and in the Legal-Economical Faculty of Adam Mickiewicz University (Poznań). Journalist: Polish Information Agency (API) and "Słowo Powszechne". Deputy chief of weekly "Za i Przeciw" and special correspondent to II Vatican Council (four sessions).

Member-cofounder of Christian Social Association (ChSS). From 1966 member of ChSS General Headquater, and later Secretary General of ChSS. Since 1974 till now Chairman of ChSS.

Member of Presidium of National Council of Polonia Society for Relations with Poles Abroad. Member of National Council of PRON (Patriotic Movement of National Rebirth).

Deputy to Seym (Polish Parliament) VII, VIII and IX terms (Member of Foreign Relations Committee and Chairman of ChSS Parliamentary Group).

Since 1982 member of the Council of State.

For File

POLAND.

TOTAL P.01

JWS + LARI
9/13
12:30

FORM NO. 80
(5–84)

THE WORLD BANK/IFC
MESSAGES

DATE 8/16

TIME 2:30

TO JWS o/r

FROM Molly

DEPT./OFFICE Doug Coes

PHONE 522-0266 EXTENSION

- [x] CALLED
- [ ] CAME TO SEE YOU
- [ ] RETURNED YOUR CALL
- [x] CALL BACK
- [ ] WILL CALL AGAIN
- [ ] REQUESTS APPOINTMENT

☐ URGENT + 2 WBANK.

REMARKS ~~PETER KONSWACKI~~ -
KASIMIR MIROWSKI -
6-12 Sept.
~~DINNER~~ OR LUNCH. on 13th
(ask Eugenia Lori to join us -

RECEIVED BY CF

Roland

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

January 17, 1989

Dear Mr. Ilczuk:

Just a note to thank you for sending me the bottles of Polish Wodka which you so thoughtfully sent to me. Mrs. Conable and I are looking forward to sampling it during the new year. Thank you for giving us the opportunity to enjoy this fine product of your country.

Please accept my sincere thanks and best wishes for 1989.

Sincerely,

Barber Conable

Andrzej Ilczuk, M.A.
Financial Attaché
Embassy of The Polish
People's Republic
2640 16th Street, N.W.
Washington, D.C. 20009

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190820 POL :PM-POLAND 1STLD URGENT
POLISH PRIME MINISTER OFFERS GOVERNMENT'S RESIGNATION

WARSAW, Sept 19, Reuter - Polish Prime Minister Zbigniew Messner offered his government's resignation on Monday after a scathing parliamentary report on its economic performance in the past year.

"Guided by the supreme interests of the state, I submit the resignation of the council of ministers," Messner told parliament.

MORE AJB ABD

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190820 REL :(RPT)PM-POPE 1STLD (EXPECT PIX)
POPE LEAVES MOZAMBIQUE ASKING GOD TO BLESS AFRICA

By Pascal Fletcher

MAPUTO, Sept 19, Reuter - Pope John Paul flew home on Monday after nine days in Africa, asking God to bless the continent and telling its people to solve their problems with love instead of violence.

The Pope's Alitalia jet took off for the journey back to Rome after he told a crowd of 10,000 people at Maputo airport that only a change in spiritual attitudes could save the troubled southern African region.

The crowd packing the airport to see him leave included drum bands and warriors who performed an elaborate farewell dance, crashing their hide shields to the beat of the drums.

MORE PF JA

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190821 POL :PM-POLAND 1STLD =2 WARSAW

(May be bylined Tony Barber)

The government's offer to resign came three days after Poland's Communist authorities, in an abrupt switch of policy, agreed with the outlawed Solidarity trade union to open broad talks on the country's future.

If Messner and his government left office, it would not affect the make-up of Poland's most powerful political body -- the Politburo of the ruling Communist Party.

Nevertheless the resignation offer amounted to an acknowledgement of grave economic mismanagement in a year which has already seen two waves of pro-Solidarity industrial strikes over soaring inflation and goods shortages.

Messner offered to resign after a report by a special parliamentary committee which said such a move was the only way of restoring popular confidence "in the government and the centres of power in the country".

MORE AJB RT

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"It is indispensable that deep changes be made in the composition of the government," Communist deputy Krystyna Landyjendroska said in presenting the committee's report to parliament.

"Recent unrest...has deepened doubts over whether the government in its present form, having lost social confidence to a large extent, can effectively continue the process of reforming the economy."

The deputy called for the inclusion of more non-Communist politicians and technocrats in the government, which is nominally a coalition headed by the Communist Party.

Solidarity leader Lech Walesa and his colleagues say the authorities will not regain popular confidence unless they restore legal status to his union, which was suppressed under martial law in December 1981.

The authorities have said they may re-legalise Solidarity, but both party and opposition sources say the suggestion has caused serious divisions inside the party.

Messner alluded to frequent bickering inside Poland's political establishment over the effectiveness of government attempts at economic reform.

"No one can effectively function in an atmosphere when he is constantly being discredited and even insulted," Messner said.

"The demonstrative rejection of everything which the central administration proposes not only paralyses reform, it paralyses the entire state system."

In making their approach to Solidarity, the authorities said they were prepared to consider radical new methods of solving Poland's political and economic problems.

They said that only people who rejected the country's constitutional system would be excluded from this process.

(NO PICKUP)
REUTER AJB RT

-(DJ-09-19-88 1027GMT)

POLISH PRIME MINISTER, CABINET RESIGN IN FACE OF PUBLIC CRITICISM

WARSAW -(DJ)--THE GOVERNMENT OF PRIME MINISTER ZBIGNIEW MESSNER RESIGNED MONDAY IN THE FACE OF SHARP CRITICISM OF ITS ECONOMIC PERMORMANCE, CITING "THE HIGHER INTERESTS OF THE COUNTRY."

THE RESIGNATION OF MESSNER AND ALL 19 GOVERNMENT MINISTERS CAME IN A SPEECH BY MESSNER TO THE SEJM, OR PARLIAMENT. HE SAID THE RESIGNATIONS WOULD MAKE IT EASIER FOR PARLIAMENT TO MAKE "PROPER DECISIONS" ABOUT THE GOVERNMENT"S FUTURE.

MESSNER, PRIME MINISTER SINCE 1985, ANNOUNCED THE RESIGNATIONS AT THE END OF A 30-MINUTE SPEECH IN WHICH HE OFFERED A DEFENSE OF HIS GOVERNMENT"S PERFORMANCE BUT ADMITTED TO "MISHAPS" IN NOT STANDING UP TO PRESSURE.

"THE FALL OF A CABINET, KNOWN SO WELL IN MANY COUNTRIES OF THE WORLD, IS NOT SHOCKING AS SUCH. BUT WE SHOULD BE AWARE THAT BY OVERTHROWING GOVERNMENTS ONE CANNOT REACH SOCIAL AND ECONOMIC GOALS. THE GOVERNMENTS GO AWAY BUT THE PROBLEMS REMAIN," HE SAID.

HE IMPLICITLY ACKNOWLEDGED THAT HIS GOVERNMENT HAD LOST PUBLIC CONFIDENCE.

"THE GOVERNMENT THAT WILL UNDERTAKE REALIZATION OF THE KEY ECONOMIC AND SOCIAL PROBLEMS MUST BE ACTING WITHOUT BURDENS," HE SAID. "IT MUST HAVE A RESERVE OF TRUST.

"LED BY THE HIGHER INTERESTS OF THE COUNTRY AND THE INTENTION OF MAKING IT EASIER FOR THE SEJM TO MAKE PROPER DECISIONS IN THE PRESENT SITUATION, I ANNOUNCE THE RESIGNATION OF THE COUNCIL OF MINISTERS," HE SAID.

-(DJ-09-19-88 1031GMT)

ON NEWS

.ING GOLD FIXING

.-KILO BAR 83,800 FRANCS PER KILO (410.62 DLRS PER
), COMPARED WITH 85,250 FRANCS (415.10 DLRS) FRIDAY
.RNOON

-(DJ-09-19-88 1034GMT)

POLISH RESIGNATIONS -2: 60-PC INFLATION RATE

IT WASN'T ANNOUNCED WHEN A NEW GOVERNMENT WOULD BE NAMED, AND IT REMAINED POSSIBLE THAT MESSNER OR SOME OF HIS MINISTERS COULD BE REAPPOINTED BY THE PARLIAMENT. IT ISN'T REQUIRED UNDER SEJM RULES THAT A NEW GOVERNMENT BE APPOINTED IMMEDIATELY.

THE CURRENT MINISTERS WOULD CONTINUE TO SERVE UNTIL NEW APPOINTEES ARE NAMED.

THE GOVERNMENT WAS CRITICIZED AS SLUGGISH AND INEFFECTUAL IN IMPLEMENTING A BROAD ECONOMIC REFORM PLAN THIS YEAR AND FOR ITS HANDLING OF PRICE HIKES WHICH HAVE RESULTED IN ANNUAL INFLATION OF 60 PC.

THE PRICE-HIKE OPERATION HAD BEEN FAULTED BECAUSE WAGES, UNDER PRESSURE FROM WORKERS, WERE ALLOWED TO RISE FASTER THAN PRICES, WIPING OUT ANY BENEFITS TO THE ECONOMY FROM THE HIGHER PRICES.

THE GOVERNMENT WAS GIVEN SPECIAL POWERS IN MAY TO DEAL WITH THE SITUATION BY SUCH MEANS AS OVERTURNING UNJUSTIFIED WAGE DEMANDS OR CLOSING DOWN POORLY MANAGED ENTERPRISES. BUT CRITICS SAID IT HADN'T PUT THE ADDED AUTHORITY TO GOOD USE.

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-(DJ-09-19-88 1034GMT)

...GMT)

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Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Poland - Country Files - Correspondence - Volume 1	1779845

Document Date	Document Type
February 9, 1988	Letter

Correspondents / Participants
To: Mr. Timothy Thahane VP and Secretary IBRD
From: Mr. Wladyslaw Baka, Governor of the World Bank

Subject / Title
ED Constituency

Exception(s)

Additional Comments
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Poland

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: October 20, 1988

NAME	ROOM NO.
Messrs. Qureshi (o/r) SVPOP	E1241
W. Thalwitz EMNVP J.W. Stanton EXC	H12-071 E1227
Mrs. M. Haug, EXC	E1229

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	NOTE AND FILE		**URGENT**

REMARKS:

FROM:	ROOM NO.:	EXTENSION:
E. F. Lari	H11-067	32552

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

cc with. M. Q. ⁰/ₒ Mar. H. J.W. Stant file

DATE: October 20, 1988

TO: Distribution

FROM: Jane Loos, Senior Country Officer, EM4CO

SUBJECT: POLAND - New Government

1. Prime Minister Rakowski announced the formation of his new Government last week, which includes members of all three active parties--PUWP, Peasants Party, and Social Democrats (as did the previous government). Rakowski explained that he attempted to include representatives of the "constructive opposition" for the posts of one the four Deputy Prime Ministers, Minister of Labor and Social Policy, Minister without portfolio for relations with social groups, and Secretary of State in Ministry of Regional Planning and Construction, but the persons to whom he offered the posts turned them down; therefore, Rakowski said he was leaving the posts vacant, meaning he's leaving the door open for future cooperation. There was no realignment of ministries, with one exception. Rakowski did not nominate a Chairman for the Planning Commission, explaining that he intended to send forward shortly a proposal to change the role and position of the Planning Commission after discussing and working out the details with the members of his new government. The hot rumors are that the Planning Commission will become a special institute/think tank, and that many of its former powers of direct interference in the management of the economy will be taken over by other ministries or else abolished.

2. The government includes four deputy Prime Ministers and 19 Ministers. (See attachment I for new Ministers; Deputy Ministers and Secretaries of State have not yet been formalized). The major changes are concentrated in the Deputy Prime Ministers and the economic ministries. Given their backgrounds, it appears that the three Deputy PMs named will divide up duties in three main areas--agriculture, labor relations and economic reform. One Deputy PM is concurrently the Minister of Agriculture, the second is formerly the Minister of Labor and Social Policy, and the third is the author of numerous articles on political aspects of organization and management and different forms of economic organization; he also was a member of the commission for review and modernization of the economy and state structure which advised the Sadowski team. The group includes nine hold-overs from the last Messner cabinet (Interior; Defense; Foreign Affairs; Regional Planning and Construction; Transport, Shipping and Communications; Culture; Religious Relations; Chief of Bureau of Council of Ministers; and one other without portfolio). Several others were promoted from other posts in the

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Distribution:

Messrs./Mmes. Lari, Harrison, Zaidan (EM4); Nouvel, Lav, Milanovic, Chutikamoltham (o/r), Hilton, Matic (EM4CO)
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Sood, Busz, Cordet (o/r), Craig, Reyes-Vidal (EM4IE)
Hinds, Amin, Ewing (EMT); Al-Jabri (LEG)

previous government. The average age of the new members is 50. Of special interest for our activities are: Minister of Finance, Andrzej Wroblewski, formerly in Ministry of Industry and close collaborator with Baka; Minister of Foreign Economic Cooperation, Dominik Jastrzebski, former head of PAGED foreign trade company; Deputy Prime Minister and Minister of Agriculture, Kazimerz Oleshiak, Sjem committee head on agriculture and agriculture PhD from the Peasants Party--from which the Agriculture Minister is usually taken; Minister of Industry, Mieczyslaw Wilczek, co-owner of joint venture LAVIL. The Minister for Environment, Josef Koziol, was a Deputy Prime Minister under Messner. The new Minister of Health and Social Welfare, Dr. (Mrs.) Izabella Planeta-Malecka, is a nonparty member.

3. In his speech, Rakowski commented that his presentation to the Sjem and the Polish people was not going to include an outline of promises of what the Government would do, but rather he wished the government's actions to speak for themselves. A separate report was presented to the Sjem to explain the condition of the country as the Rakowski government is taking over. He said the government would strictly adhere to the current economic policy and the reform programs as laid down in law. The government was prepared to implement the reform program consistently, but he also asked pointedly if the country was ready to put up with the effects of reforms implemented consistently, such as enterprise closings, diversification of wages, with winners and losers. The government would seek simple, logical and effective solutions, but most importantly, the selected solutions must be understandable and acceptable to the population at large.

4. He explained that the top priority task facing the government was development of agriculture and food economy, to enable Poland to feed itself and export a bit. He made some remarks about the branch officials (possibly from former industry subsectors) not granting sufficient priority to meeting the input needs of the agriculture sector. The second priority was housing construction; third was environmental protection. In the industrial sector, priority would be given to production satisfying the basic needs of families and selected fields to bring the quality of life closer to European standards. He did note that the success of nearly all the government's priority programs hinged on development of profitable exports, to enable increased imports as well as debt service. He also noted that the government is preparing a "consolidation" program which will include corrections in economic policy to address these revised priorities. (We suspect that this is the same consolidation plan for macroeconomic planning over the next 18 months being worked on for discussion with the IMF.)

5. In terms of country relations, Rakowski pointedly asked the US to live up to its public statements and support those encouraging solid reforms, noting that there are no more reasons for checking the cooperation with international financial organizations (note: words sound a lot like the US State Department position vis a vis US Treasury). The allusions to being ready for a breakthrough in relations with FRG were a bit obtuse, but listed second only to the issues with the US. He also noted that the government was working hard to regularize the legal status of the Polish Catholic Church and even to establish relations with the Vatican.

6. Rakowski also referred to the forthcoming roundtable talks, noting that there is a lot of room for compromises, but that the other side seemed to be posturing to maximize demands without having their hearts in the process or being willing to accept co-responsibility for the outcome. He reiterated that the question of following the socialist approach and continuing the socialist state were not on the table for discussion.

POLISH GOVERNMENT
Formed October 1988

Prime Minister Rakowski PUWP

Deputy PM Kazimierz Olesiak ZSL
(and Minister of Agriculture, Forestry and Food Economy)
Deputy PM Janusz Patorski PUWP
(formerly Secretary of Warsaw section of Party)
Deputy PM Ireneusz Sekula PUWP
(formerly Minister of Labor and Social Policy)
Deputy PM Vacant

Ext. Econ. Coop. Dominik Gastrzebski PUWP
Finance Andrzej Wroblewski PUWP
Health and Social Welfare Izabella Planeta-Malecka no party
(formerly Director of Pediatrics, Lodz)
Industry Mieczyslaw Wilczek PUWP
Internal Market Marcin Nurowksi SD (formerly VP of Warsaw City government)

Construction and Reg. Planning Bogumil Ferensztajn PUWP, retained
Environment Jozef Koziol PUWP, (formerly Deputy PM)
Transport, Ship., and Com. Janusz Kaminski PUWP, retained

Labor and Social Policy vacant

Education Jacek Fisiak PUWP (formerly Rector Poznan Univ.)
Chief of Office of Science and Technology Zbigniew Grabowski PUWP
(formerly Rector Warsaw Technical Univ.)

Justice Lukasz Balcer SD
(formerly Under Sectretary of Environment)
Culture Aleksander Krawczuk PUWP, retained
For. Affairs Tadeusz Olechowski PUWP, retained
Defense Florian Siwiski PUWP, retained
Interior Czeslaw Kiszczak PUWP, retained
Chief of Office of Council of Ministers Michal Janiszewski PUWP, retained
Minister without Portfolio Alesksander Kwasniewski PUWP, retained
Chief of Office of Religious Affairs Wladyslaw Loranc ?, retained

~~① MH~~
② ~~BBC o/r~~
③ CP - file

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 5, 1988

TO: Memorandum for the Record

michael lav

FROM: Michael Lav, Sr. Economist, EM4CO

EXT: 32556

SUBJECT: Poland - Mr. Conable's Meeting with Deputy Prime Minister Z. Sadowski

1. Professor Zdzislaw Sadowski, Deputy Prime Minister of the People's Republic of Poland, met with Mr. Conable on June 28 for about one hour. He was accompanied by Mr. Andrzej Dorosz, Deputy Minister of Finance; His Excellency, Ambassador Jan Kinast; Mr. Cezary Stypulkowski, Advisor to Professor Sadowski; and Mr. Andrzej Ilczuk, Financial Counselor at the Polish Embassy in charge of relations with the World Bank. Also present were Messrs. Stanton, Thalwitz (EMNVP), Lari and Lav(EM4).

2. Mr. Conable welcomed Professor Sadowski and asked him about progress on implementing the reform, and the commitment to the reform at the highest levels of government. Professor Sadowski responded that there was no doubt about commitment at the highest level. Some results of the reform were already evident, such as the strong export growth of the last year. Mr. Conable commented that while imports had also increased, productive imports were important. Professor Sadowski noted that imports had comprised capital goods as well as intermediates needed for production. The objective of the reform was to move Poland towards a market economy and that the legal and administrative framework for this was being implemented. Three key features of this was the law granting equal status to non-socialized and socialized enterprises, the law granting free entry for all enterprises, and the revised joint venture law to attract foreign capital. There was no doubt about the political determination to implement the three year program. This would involve considerable restructuring of the economy while management of the investment program was being decentralized towards enterprises and regional authorities. Mr. Conable enquired whether subsidy reduction was part of the restructuring effort. Professor Sadowski confirmed that government was closing 21 enterprises rather than continuing to subsidize them, and that more enterprises would be subjected to this discipline; special programs were being formulated to restructure the shipbuilding industry.

Cleared with & cc: Messrs. Thalwitz (EMNVP); Lari (EM4)

cc: Messrs./Mmes. Conable, Stanton (EXC); Qureshi (SVPOP);
Hasan (o/r), El-Maaroufi (EMNVP);
Zaidan (EM4); Nouvel, Harrison (o/r), Lav, Milanovic,
Loos (o/r), Chutikamoltham, Hilton (o/r)(EM4CO);
Apitz (EM4IN); Ramasubbu (EM4AG), Sood (EM4IE)

MLav/mct
2768G

3. Concerning the overall rate of progress, Professor Sadowski confirmed that government would move as rapidly as possible. Government intended to go ahead with price liberalization, but this was a difficult area. Progress would depend on international cooperation. While even without any international cooperation, Poland would implement the reform, such cooperation would make possible a more rapid and effective reform. He then enquired whether Poland could count on IBRD abd IFC financing.

4. Mr. Conable responded that we were edging towards an agreement but that progress was needed between Poland and the IMF. He understood that Poland, with a target of balancing the current account of the balance of payments in 1991 and the IMF with a target of 1989 were not too far apart, although there remained questions concerning price and interest rate policy, amoung others. However, Mr. Conable stated that he was optimistic about further progress and that he was expecting a lending program to materialize in FY 89. The staff added that discussions tomorrow would focus on a minimum package which would be needed for support, including the role of the IMF. Projects could be mobilized quickly to support development on the supply side, and that there was a need to work with the IMF concerning demand management. Appropriate burden sharing amoung other creditors would be important.

5. Mr. Conable asked whether there was difficulty in enlisting popular support for the program. Professor Sadowski responded that while there was an alleged lack of support, the results of the November referendum contradicted this view since 12 million Poles had voted for a reform package which identified the need for self-restraint, against the 5 million who voted against the package. He acknowledged that price policy was the most difficult aspect of the program. Mr. Conable noted that government had changed the schedule for reform implementation after the vote, while staff added that popular support for a new price system would be a key element in the reform. While acknowledging some changes in the schedule for the reform, Professor Sadowski mentioned that coal and energy prices had been increased substantially so that relative price structure was improved. However, there was a problem controlling money incomes. While this was not a typical inflation problem because much of the overall price level increase was due to the discrete increase of February following the large increase in energy prices, government expected lower price increases in the future and to be able to reduce real income increases by adjusting upwards prices of alcohol and tobacco products. Retail food prices would remain a sensitive and difficult area, but other prices could be liberalized.

6. Professor Sadowski continued by noting that restructuring the real sectors of the economy was an urgent task of the reform. Closure of some enterprises would be important here, as would adjusting the investment program. Foreign capital would play an important role. A number of small and medium scale enterprises had been established by expatriate Poles in the past under a special "Polonia" program, and more than 30 joint ventures had been established this year. Energy was a particularly important sector and some inefficient coal sector investment had been stopped, partly in response to IBRD recommendations. But long-term planning was important for energy, and requirements for the future limited the options in the present. Steel was another sector where substantial adjustment was planned. Government wanted the World Bank to participate in the restructuring effort of the economy, and hoped for private sector participation as well.

7. Mr. Conable interjected that at some point in the not too distant future financial support would be important. Staff emphasized that agreement was needed on measures which would be adequate to merit support. Concerning other creditors, staff enquired as to the status of discussions. Professor Sadowski noted that Poland was asking Paris Club member countries for some fresh money as well as lower interest rates. Mr. Conable agreed that this was a proper request although it was important to be realistic. Professor Sadowski stated that Poland was trying to be flexible in its approach. Minister Dorosz confirmed that Poland was seeking only small packages of new money, and some relief from the high interest rate structure it had faced since the early 1980's. Perhaps the difficulty of achieving this had been underestimated.

8. Mr. Conable asked whether progress was expected. Minister Dorosz noted that Poland was very close to signing an agreement with the London Club, but that the Paris Club, which held the large majority of Poland's debt to the West, was a more difficult case. Poland hoped to negotiate a longer-term debt restructuring, including a lengthening of maturities, as had been negotiated for other countries.

9. Mr. Conable stated that the IMF was the key for resolving these problems. Professor Sadowski stated that Poland would work with the IMF on an adjustment program, and that World Bank participation in such work with the IMF would be welcomed. Perhaps the IBRD projects could be launched in parallel with such work, provided sufficient progress had been made. Mr. Conable agreed; it was recalled that a similar suggestion had been made earlier. The essential point was that the IBRD and IFC could proceed when an agreement between Poland and the IMF had been reached, even if some administrative steps remained for formal IMF approval. Professor Sadowski noted that some stumbling blocks remained concerning progress with the IMF, but that government would work on this.

10. Mr. Conable concluded the meeting by noting the progress which was being made, and stating that he was encouraged that the Deputy Prime Minister could visit Washington to present the government's position so ably.

6/27.

JWS

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 15, 1988

TO: Distribution

FROM: Eugenio F. Lari, Director, EM4

EXT: 32552

SUBJECT: POLAND: Seminar on the Economic Reform

Professor Zdzislaw Sadowski, Deputy Prime Minister and Chairman of the Planning Commission in Poland, has rescheduled his visit to Washington and will now be here the week of June 27, 1988. Professor Sadowski is a key sponsor of the reform program in Poland and has kindly agreed to conduct a seminar on this subject at 10:30am on Tuesday, June 28, 1988. He is a first-rate economist and an excellent speaker. I would very much hope that you can attend the seminar, which will be held in the Eugene Black Auditorium (C-1114) and is expected to last for about two hours.

N

As seating for this seminar is limited and we plan to invite several persons from outside the Bank, we need to know if you plan to attend. I would appreciate it, therefore, if you would kindly let Ms. Rochelle Hilton (ext. 32547) or Ms. My Chau Tran (ext. 37031) know, whether or not you will participate in the seminar. No background papers are being prepared.

NO

Distribution:

Messrs./Mmes. Stanton, Haug, Tanaka (EXC)
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RHilton/mct
2698G

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 88/06/24 DUE DATE : 00/00/00
LOG NUMBER : 880627001 FROM : E. Lari (thru WT & M
SUBJECT : POLAND: Mtg. with Deputy Prime Minister Sadowski on Monday, June 27 at 5:00 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_______ APPROVED
_______ PLEASE HANDLE
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_______ FOR YOUR REVIEW AND RECOMMENDATION
_______ FOR THE FILES
_______ PLEASE DISCUSS WITH _______________
_______ PLEASE PREPARE RESPONSE FOR _______________ SIGNATURE
_______ AS WE DISCUSSED
_______ RETURN TO _______________

COMMENTS :M. Haug, J. Volk (FF)

Note: Received from Qureshi's office on June 27, 8:36 am.

*IMPORTANT

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 24, 1988

TO: Mr. Barber B. Conable

THRU: Mr. Wilfried P. Thalwitz (EMNVP) and Mr. Moeen A. Qureshi (SVPOP)

FROM: Eugenio F. Lari, Director EM4

SUBJECT: POLAND - Visit of Deputy Prime Minister Sadowski

1. You will meet with Professor Sadowski on Monday, June 27, at 5:00 pm. During the coming week, Professor Sadowski will have meetings with Sir William Ryrie and with me and EMENA staff. He is also expected to meet with Mr. Camdessus, Mr. Bush and Mr. Schultz prior to your meeting, and possibly Mr. Baker and members of Congress later in the week. Professor Sadowski will conduct a seminar on the Polish reform program for interested Bank Executive Directors and Bank/IMF staff, officials from the US government and Congress, academics, business leaders, and international bankers. Mr. Qureshi is scheduled to meet with him on Friday, July 1 at 9:30 am, before which we will provide a supplemental briefing on developments during the week's visit. As you will remember, the World Bank conveyed invitations to Professor Sadowski earlier in the spring, but his visit in May was postponed due to labor unrest.

2. Professor Sadowski is one of the main architects of the current economic reform in Poland, and is in charge of its implementation. In addition to his post as Deputy Prime Minister, he is also the Chairman of the Planning Commission. He is not a party member, but is very close to President Jaruzelski. He will be accompanied by Mr. Andrzej Dorosz, Deputy Minister of Finance and main interlocutor at the Paris Club; His Excellency Jan Kinast, Polish Ambassador to the United States; Mr. C. Stypulkowski, Adviser to Professor Sadowski; and Mr. Andrzej Ilczuk, Financial Counsellor at the Embassy.

Recent Developments and Prospects

A. Political

3. Political developments are mixed. The ruling party recently made major changes in the membership of the Politburo, which is the highest decision-making body of the party, made up of President Jaruzelski in his capacity as First Secretary of the party, the Prime Minister and 8 others. In the recent reshuffle, a number of strong reform supporters were appointed to the Politburo, including Professor Baka, President of

the National Bank of Poland and Governor for the World Bank, who will now be the secretary of the Politburo in charge of economic affairs. The recent outburst of labor unrest has subsided, as the population in general seems unwilling to support more overt forms of disagreement with the Government, including Solidarity programs. Nonetheless, the population remains skeptical of the Government's intentions and capacities to pursue a meaningful reform, as recently manifested in an exceptionally low turnout for regional elections. A similar skepticism exists among Poland's external creditors, although some Governments--especially West Germany and possibly the UK--are warming up to the idea of providing support to the present Government reform efforts.

B. Economic

I. General

4. Economic developments are also mixed. GDP, after growing by 2% in 1987, is expected to rise by 4% in 1988, while work on defining, refining and implementing the broad economic reform program is proceeding. To set the framework for some of these reforms, a law granting uniformity of treatment to all sectors (socialized and nonsocialized) is being discussed by Parliament. The Government also received recently extra-ordinary powers from Parliament to push through with its reform program, including powers to sack officials and break-up enterprises which are resisting the implementation of the reforms, as well as to act to contain inflationary pressures/price gouging which may occur as the unintended result of some of the liberalized rules for enterprise activity.

5. A major reorganization of the central government was implemented last December, abolishing branch ministries which used to control enterprise activities. Foreign trade reforms have been introduced with positive results, as witnessed by the solid expansion of exports (see para. 6 (a) below). Work on banking sector reform is proceeding, with nine commercial banks to begin operations in 1989. A review of public investments in the central administrative budget has resulted in welcome elimination or reduction of some projects of dubious merit, although this represents only a minor portion of total investments as the majority of investments are controlled at the enterprise level. The pace of price realignment/adjustment, however, is slower than originally planned (in response to the results of the November 1987 referendum) and further liberalization of the institutional arrangements for setting prices is not part of the immediate program.

II. External Balance

6. Key factors to be considered include:

a) The balance of payments outturn for 1987 was better than projected, with a convertible currency current account deficit of only $400 million (about 0.6% of GDP) or about half of the $800 million deficit projected by the Government. Convertible currency exports increased by 10% in real terms in 1987 (in response to a 60% real devaluation of the zloty since 1986 and liberalization of the trade regime) and their rate of increase so far in 1988 exceeds 20% in real terms. In spite of the buoyant exports, the Government forecasts a current account in balance only in 1991, due to its present policy of letting imports also grow fast.

b) Some progress on external debt management, but still inadequate. Negotiations with the London Club are drawing to a close, and agreement on the final technicalities of a six year rescheduling (1988-93) covering nearly all commercial debt is expected shortly. A rescheduling with the Paris Club (for the debt due through the end of 1988) was agreed in principle in late 1987, but completion of the specific bilateral agreements with the Club members is taking longer than planned, largely because Poland insists that interest rates, which are negotiated bilaterally, should be lowered. Poland has also requested token amounts of new commitments from Paris Club members (including a normalization of trade financing as Poland is requested to pay cash for most of its imports), but the response so far has been lukewarm.

c) The slowly evolving dialogue with the IMF. The IMF recently completed its third Article IV Consultation. A report will be submitted to their Executive Directors for discussion in September. While the Government indicated its intention to pursue a stabilization program with IMF support, it is not clear when such general intention will be transformed into a more formal negotiation. The projected trade and current account figures are under active discussion with the IMF, which has indicated that achievement of current account balance in 1989--which would imply a capacity for full payment of interest on Poland's external debt--is a precondition for IMF support. As indicated above, the Government has so far not agreed on this.

III. Internal Balance

7. Key factors which negatively affect the balance are:

a) Inflation, which in 1987 was about 26% and in 1988 is expected to increase to about 60%, reflecting recent price increases and realignments which were introduced by administrative measures to try to stabilize the economy. Despite Government intentions to limit wage increases in the socialized sector to a few points less the projected rate of inflation, recent wage settlements have exceeded it, undercutting the Government's capacity to stabilize the economy.

b) Interest rates, which, although increased, are still very negative in real terms on an annual basis. This discourages savings, fuels inflation, and together with the low pace of price liberalization (see above para. 4), causes misallocation of resources. If, however, the Government succeeds in constraining inflation from now on, as per its stated intentions, the rate of inflation would decline in 1989 and the recently increased interest rates would become positive in real terms. The issue is the capacity to adjust interest rates flexibly.

c) Financial discipline, which is still lacking at the enterprise level, because of continuing budget transfers to loss-making enterprises, equivalent to about 6% of GDP.

Recommendations

A. The Reform

8. You should give Professor Sadowski the opportunity to provide information and analysis of the reform in Poland. Therefore, after noting with appreciation the successful export drive, and the slimming down of the central administration, you may wish to inquire about the Government's views on the prospects for fully implementing the reform and how it plans to foster and build up the necessary support domestically and internationally.

9. You should then enquire about the Government's debt strategy and plans to eliminate the current account deficit. You should stress that the recovery of current account balance is crucial to Poland's ability to restore creditworthiness and assemble a satisfactory financing package for its reform program, while noting the small additional effort needed to meet this goal.

10. Finally, time permitting, you may wish to enquire about their price liberalization policy (how rapid is the liberalization ?) interest rate policies (progress in reaching positive real rates on both deposits and loans?), wage policies (are increases excessive relative to price changes?), and financial discipline (are subsidies and tax rebates being reduced?).

B. The Bank Group and Poland

11. Professor Sadowski will likely raise the question of what type of support the World Bank is prepared to offer to Poland and when and under what conditions such support will be given. We have consistently explained that the World Bank would be prepared to inititate a lending program (about $250 million in the first year) when the Government began implementing a credible, medium-term economic reform and debt management program which would enable Poland to restore creditworthiness over time and to secure financial assistance from the IMF, the Paris Club and the London Club. In that expectation, we have prepared a number of lending operations [1/] which would be suitable vehicles for such financial support. However, we have not yet initiated loan negotiations for these projects (See attached FY89-90 lending program). IFC has also completed preparations for its proposed first operation, a $17.9 million equivalent loan to an agroprocessing cooperative, which is also ready for negotiations. We recommend that you restate the Bank position as outlined above, indicating the Bank's readiness to help as witnessed by the intense economic and sector work, project preparation, and policy dialogue of the past two years, but also stressing the necessity that Poland reach agreements with the IMF and the Paris and London Club members--which you should encourage them to pursue urgently.

12. Another issue Professor Sadowski may raise is the question of membership in a constituency at the Board of Executive Directors. You will recall that in a meeting with you, Professor Baka asked for assistance in completing such arrangements. It appears that their negotiations with the Italian chair continue to be inconclusive, and that they may wish to pursue other options. As you know, a group of Bank Executive Directors will visit Poland June 26-July 1. The matter of constituency is becoming increasingly embarrassing to Poland, especially now that Poland is completing arrangements for IDA membership. The Polish Ambassador will formally sign IDA documents on June 28. You may wish to express your appreciation.

Attachment

cc: Messrs. Hasan (EMNVP); Nouvel, Harrison, Lav (EM4COD); Zaidan (EM4); Ramasubbu (EM4AGR), Sood (EM4I&E), Apitz (EM4INF).

JLoos/EFLari:nsp

1/ Professor Sadowski may inquire about the status of the Government's request for an advance from the Project Preparation Facility for the Industrial Export Development Project, which is under consideration by EMENA Regional Management. If he does not inquire, it is not necessary to raise the topic.

POLAND

Proposed FY89-90 Lending Program

FY89

Industrial Export Development Project $250 million

Standby Operations--	Agroindustries Exports	$ 75 million
	Energy I	$250 million

FY90

Agroindustries Exports	$ 75 million
Energy I	250 million
	325 million

Standby Operations--	Industrial Restructuring	$150 million
	Transport I	$100 million

June 23, 1988

Country File

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

July 15, 1988

Dear Professor Baka:

Thank you for your letter on Poland's external adjustment. The memorandum which you attached provided me with an excellent opportunity to learn more about Poland's ambitious reform program and it is a useful complement to my discussion with Professor Sadowski which recently took place.

There is much to be done in the coming months to implement these measures and it is our hope that your efforts will establish a firm base on which to initiate Bank lending to Poland.

Sincerely,

Barber Conable

Professor Wladyslaw Baka
President
National Bank of Poland
Warsaw, Poland

~~DPAH~~ (has own copy)

2) JV for follow-file

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/07/25 DUE DATE : 00/00/00
LOG NUMBER : 880726001 FROM : Qureshi/Lari
SUBJECT : Briefing - POLAND: Visit of Foreign Minister Tadeusz Olechowski
July 27, 4:30 p.m.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

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COMMENTS :cc: MH
JV (retain for follow file)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 25, 1988

TO: Mr. Barber B. Conable

THRU: Mr. Moeen A. Qureshi, SVPOP

FROM: Eugenio F. Lari, Acting EMNVP

SUBJECT: POLAND--Visit of Foreign Minister Tadeusz Olechowski

1. You will meet with Polish Foreign Minister Tadeusz Olechowski (pronounced OH-LEH-HOV-SKI) on Wednesday, July 27, at 4:30pm. He is likely to discuss the issue of Poland's representation at the Board. He may also discuss the status of Poland's evolving relations with its external creditors.

Recommendations

2. We recommend that: (a) you offer to support Poland's efforts to join a constituency at the Board; (b) commend the recent completion of final agreement with the London Club and encourage continued dialogue and agreement with the Paris Club; and (c) enquire about political support within Poland for the reform.

Background

3. Mr. Olechowski was appointed Foreign Minister in the recent Government reshuffle, and is visiting the United States at the invitation of Mr. George Schultz. A copy of Mr. Olechowski's CV is attached. He will be accompanied by His Excellency Jan Kinast, Ambassador, and Messrs. Boniuk and Krowacki, Financial Counsellors at the Polish Embassy.

4. The matter of Board representation has been raised by senior Polish officials on a number of occasions. During the 1987 Annual Meetings, Professor Baka (Governor for the Bank) requested your assistance in making arrangements for Poland to join a constituency. The group of Executive Directors [a/] which recently visited Poland also reported that the Foreign Minister and other Polish officials had sought their advice and support in coming to satisfactory arrangements to join a constituency; the Executive Directors strongly recommended to Mr. Thahane that Bank management become more actively involved, although this is normally a matter for member countries to resolve among themselves.

5. When Poland joined the Bank two years ago, it tested a number of possibilities for joining a constituency, including the Belgian, Dutch and Italian groups, and has been pursuing the Italian constituency since that time. These efforts have been inconclusive, as the Italians let it be knownthat they could be convinced to agree only if the other members of their

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a/ Messrs. Camarasa, Ishikawa, Kantola, Potter and Zhang

cc: Messrs. Thahane, Crevier (SEC); Thalwitz (o/r)(EMNVP);
Nouvel (o/r)(EM4CO)

JLoos
2632G

group also would agree, but so far the other members have not responded to the Polish overtures. There have been a number of high-level consultations between the Polish authorities and the Italians recently, as well as some renewed activity concerning the Dutch chair, and it is possible that Mr. Olechowski may seek your advice and assistance on how to proceed.

6. Assuming Poland subscribes to its full number of shares (made possible by the most recent reallocation of shares which enabled the Bank to increase Poland's shares from the nominal allocation made available at the time of its membership to the full number of shares to which it is theoretically eligible), Poland would hold about 0.77% of the Bank's shares. This would make Poland the 26th largest shareholder, and put it in the same league as Austria, Denmark, and Norway. It is therefore not an inconsequential partner in terms of its weight in a multicountry constituency. Nontheless, Poland has let it be known that it is willing to integrate carefully into any new constituency, and not insist immediately on a high ranking in the rotation of Board assignments within the group.

7. The failure to be accepted in a constituency is beginning to undermine the credibility of the Bank in its acceptance of Poland as a member. The Polish authorities find this situation especially troublesome, in light of the fact that they have been very open and cooperative with all operational and institutional demands made on them and the fact that Poland has been forthcoming as a contributor to IDA and is in the process of joining MIGA. It also has the potential for complicating discussions about the appropriate timing for subscribing to the incremental shares now available to Poland, as the Polish authorities have indicated that full payment for the outstanding shares should also bring with it the capacity to participate fully at the Board.

8. The London Club six-year rescheduling (covering nearly all commercial debt) has been formally signed in final form. In the final agreed documents, Poland obtained a concession from the commercial banks in the form of a further reduction in the spread, down from 15/16 agreed last year to 13/16 (i.e., similar to the spread recently agreed for Yugoslavia). The Paris Club is due to discuss Poland at the end of this month, to extend the deadline for completion of bilateral agreements putting into effect their latest rescheduling agreement which covers the period through the end of calendar 1988.

9. Subsequent to your meeting with Prof. Sadowski late last month, it appears that the plans for working with the IMF towards a stabilization program are strengthening. This contrasts with the inconclusive talks that had occurred last year. After discussions between Prof. Sadowski and Mr. Camdessus, it has been decided to aim at negotiations of a Standby in October, with a view to presenting a program for 1989 to the IMF Board by the end of calendar 1988. This is based on the assumption that Poland would continue to implement its reform programs effectively in the next few months and that the political realities would indicate likely approval by the IMF Board of a proposed Standby. IMF and Bank staff are making plans to work together with the Polish authorities on an appropriate stabilization program.

10. As noted in your discussions with Professor Sadowski, a very important variable in the prospects for the reform is domestic political support. The domestic political situation appears to be somewhat more stable than earlier this year. There are also hints of a closer collaboration being developed with the Catholic Church, including discussions of the linkages of economic and political reforms.

Mr. TADEUSZ OLECHOWSKI
Minister of Foreign Affairs
of the Polish People´s Republic

Mr.T.Olechowski was born in 1926 in Wilno.

In 1948 graduated from Jagiellonian University in Cracow, Faculty of Law and simultaneously from Cracow Academy of Trade.

He begun his work at the "Metalexport" Foreign Trade Enterprise.

In the years 1948-69 official of the Polish Foreign Trade Service; i.a. Commercial Attache in Rangoon, Burma; Commercial Counselor in Rome, Italy; top official at the "Metalexport" Foreign Trade Enterprise; Ranking official at the Ministry of Foreign Trade. In 1965 became Deputy Minister for Foreign Trade.

In 1969 nominated Polish Ambassador to France, held this post twice in the years 1969-72 and 1976-80.

In 1972 took the office of the Minister for Foreign Trade.

1974-76 Polish Ambassador to Egypt and later, 1980-1983, Deputy Foreign Minister.

In the years 1983-86 Polish Ambassador to the Federal Republic of Germany.Following his return he resumed duties as the Deputy Foreign Minister.

Since June 1988 Minister for Foreign Affairs of the Polish People´s Republic.

Mr. T. Olechowski is a member of the Polish United Workers Party.

Married, has one child.

CONFIDENTIAL

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Poland

DATE: September 30, 1987

TO: Memorandum for the Record

FROM: Eugenio F. Lari, Director, EM4

EXTENSION: 32552

SUBJECT: 1987 Annual Meetings: Mr. Conable's Meeting with the Polish Delegation on September 27.

Attendance

Polish Delegation

Prof. Wladyslaw Baka, President of National Bank of Poland
Mr. Bazyli Zamojlik, Minister of Finance
Mr. Grzegorz Wojtowicz, Director Foreign Dept., National Bank of Poland
Mr. Andrej Olechowski, Adviser to the Pres. of the Nat'l Bank of Poland
Mr. Andrzej Ilczuk, Financial Attache at the Embassy

The World Bank

Messrs. Conable
Qureshi, SVPOP
Thalwitz, EMNVP
Lari, EM4
Ms. Haug, EXC

1. Prof. Baka characterized the relations with the Bank in general and the Country Operations Department and Secretary's in particular as excellent. He gave high marks to the recently completed CEM and said that it had been given wide circulation in Poland and, most importantly, was influencing Poland's economic policies. He also stressed the full agreement of the Authorities with the findings and recommendations of several Bank missions that had visited Poland to identify and help preparing projects for Bank financing. Regarding Poland's membership in IDA and IFC, he indicated that the relevant papers would be signed in three-four weeks. As far as representation at the Board, he expressed disappointment at not yet having an Executive Director to represent Poland's interests and asked Mr. Conable for his help to settle this issue.

2. As far as the economic reform was concerned, Prof. Baka said that, with the help of Bank experts and models, the Government had reoriented the reform through a medium-term scenario focussed on exports development. Three main interdependent factors characterized the scenario: (a) structural changes to accelerate exports growth and achievement of equilibrium in the current account of the balance of payments (to be reached now in 1991 rather than in 1993); (b) a change in the system of incentives in the same direction and, (c) normalization of relations with foreign partners, including the international organizations, with whom Poland hoped it could soon have active relations that would permit the country to increase its import capacity, which was crucial to exports development.

3. The reform was also being accelerated along the following lines: (a) institutional reform, i.e. less public/administrative interventions and more opportunities for entrepreneurship and innovation; (b) restoration of basic equilibria and use of market mechanism; (c) introduction of prices reflecting real economic costs. A precise calendar of actions had been drawn, with substantial front-loading.

4. Prof. Baka then briefly mentioned the recent agreement with the commercial banks on debt restructuring, the Polish counter proposal to the Paris Club and the likely meeting of the Club in October, and the contacts with the IMF. He felt that the preconditions for Bank support had been met and that it was now up to the Bank to make a move which would greatly benefit Poland both directly and indirectly, through its positive psichological effect on the international financial environment.

5. Mr. Conable expressed appreciation for the economic reform effort and progress made to date by the Government, and for Poland's decision to join IDA and IFC.

6. Mr. Conable, Mr. Qureshi and Mr. Thalwitz went on to say that they understood how fundamental and difficult were the reform measures discussed by Prof. Baka and assured him that the Bank approved them and would support them in international fora. While several measures had already been taken and others were about to be implemented, some others (e.g. re liberalization of domestic prices and improved relations with the Paris Club) needed further clarification. All three stressed the role of the Paris Club (as well as of the IMF and commercial banks) given the magnitude of today's problems in Poland. Clearly the Bank could not go ahead alone, but would be ready to do so for a limited amount of time provided there were a clear and substantial probability for the other creditors to go ahead too in their support of Poland. Project development and appraisal were now OK but Board presentation would need agreements between Poland and the IMF and the Paris Club since the Bank could not lend to a country which was not repaying its debt to other member countries of the Bank. Mr. Conable also indicated his readiness to assist Poland in resolving the problem of representation on the Board.

7. Prof. Baka expressed overall appreciation of the Bank's position and stressed the importance of effective Bank assistance in clarifying Poland's policies and intentions in the international fora. He also expressed some slight disppointment and the hope that at least with an investment operation the Bank would give a more explicit and positive signal through lending to Poland's creditors.

EFLari:nsp

Cleared with and cc: Mr. Thalwitz, EMNVP

cc: Messrs./Mesdames: Conable; Qureshi (SVPOP), Thahane (SEC), Hasan, El-Maaroufi (EMNVP), Zaidan (EM4), Nouvel, Harrison (EM4COD), Ramasubbu (EM4AG), Sood (EM4IE), Apitz (EM4IN), Haug (EXC).

1) MH

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 00/00/00 DUE DATE : 00/00/00
LOG NUMBER : 870721017 FROM : Mr. Lari
SUBJECT : Poland: Back-to-office Report

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

3)

ACTION:

________	APPROVED
________	PLEASE HANDLE
2) ~~SWS~~ ✓	FOR YOUR INFORMATION
________	FOR YOUR REVIEW AND RECOMMENDATION
________	FOR THE FILES
________	PLEASE DISCUSS WITH ________________
________	PLEASE PREPARE RESPONSE FOR ____________ SIGNATURE
________	AS WE DISCUSSED
________	RETURN TO ________________

COMMENTS : Copy sent to BBC for his info.

FORM NO. 1599
(8-80)

THE WORLD BANK

ROUTING SLIP	DATE 7/20/87

OFFICE OF THE SENIOR VICE PRESIDENT, OPERATIONS

NAME	ROOM NO.
Mr. Conable	

	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
x	Information		Signature
	Initial		Send On

REMARKS

FROM
Moeen A. Qureshi E-1241 X73665

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

22707
0714

(2)
Please send a copy of this note to the President o/r for his info.
MAB
7/10

DATE: July 8, 1987

TO: Mr. Wilfried P. Thalwitz, Vice President EMENA

FROM: Eugenio F. Lari, Director, EM4

EXTENSION: 32445

SUBJECT: POLAND: Back-to-office Report

1. My recent visit in Poland was characterized by a series of high-level meetings with the Authorities responsible for economic management (including the Prime Minister), during which they presented to the Bank mission a "Medium-Term Scenario" which represents a substantially strengthened and accelerated program of Economic Reform, compared to the program discussed with the Bank during the last several months. This program is to be followed in two months by a detailed, time-bound action plan for 1987-88. If the action plan is satisfactory, it could provide the basis for renewed active programs with the Paris Club members and the Commercial Banks, and for assistance by the IMF and the Bank.

2. The evolution of the Government's economic programs essentially follows suggestions given by Bank staff over the past several months and the preparation and delivery of the "Medium-Term Scenario" is in response to the request we made to the Governor of the Bank (and of the Central Bank of Poland) during his visit to Washington earlier in the year. The main components of the program include:

a) a reorientation of the economy towards the market, with special emphasis on liberalizing the economic system, increasing competition, and a strong export drive in the hard currency markets;

b) trade liberalization, an active exchange rate policy, foreign exchange auctions, and a revamping of the export incentives system;

c) domestic price decontrol, with increases in the overall level of prices and changes in their structure: in particular, a policy of systematic increases in energy prices will be pursued;

d) phasing out the central system of allocation of material resources;

e) reducing the role of the budget in the redistribution of the national income, in the context of an austere fiscal policy;

f) reform of the tax system in general and custom duties in particular;

g) reform of the banking system, in the context of a restrictive monetary and credit policy, with positive real rates of interest;

h) rationalization of the investment program, revising and tightening investment criteria and increasing the productivity of capital, with particular emphasis on short-gestation investment programs.

3. Under this scenario, the country would have an increasing debt servicing capability and would make progressively larger interest payments. The positive trade balance would double between 1987 and 1991, when the current account would also be positive. The realization of this scenario, however, would require further debt reschedulings--although for declining amounts--,new long and medium-term credits from the Paris Club members, gradual conversion of revolving commercial banks short-term credits into medium-term loans, a stand-by from the IMF and Bank loans (increasing from $250 million in 1988 to $400 million in 1991).

4. During the discussions, I made clear that we would need to examine carefully the proposed programs and the following action plan, and stressed the importance of a credible and consistent set of actions in a proper sequence. I also indicated the urgency of substantial up-front action. Finally, I repeatedly stated that, if the Bank was to reach a positive conclusion regarding Poland's ability to regain its creditworthiness and actively consider lending operations, it was essential that the country secure support from the IMF, reach a mutually satisfactory arrangement with the Paris Club, and agree with the commercial banks on the restoration of their lending operations in Poland. Regarding the Paris Club, we discussed the possibility of Poland presenting to the Club in the near future its medium-term economic restructuring and external debt management program and resuming in the near future some debt service payments due to Club members. The Polish Authorities may wish the Bank to play an active role at the Paris Club.

5. The Polish Authorities seem to understand the Bank's position fully and to be intent on breaking the vicious circle in which they find themselves, seek further Bank advice, and establish conditions satisfactory to justify further Bank support via lending operations in FY88.

6. The evolution of the Government economic thinking and proposals is promising and is in part due to the intensive dialogue with the Bank during the past year. No doubt, the Government would very much like to

see an active Bank program in the country: they need the money and the advice, they hope for a catalytic role of the Bank vis-a-vis other creditors, and last but not least they want credibility for their programs. Their intentions seem serious and they show substantial agreement among themselves. However, the systemic resistance to an effective implementation of the program should not be underestimated. We intend to continue the dialogue and preparation of possible projects in close contact with the IMF (a mission of which was also in the field while I was there) as well as with the Paris Club and the commercial banks.

7. We plan to circulate the first CEM on Poland to the Board in August. The Authorities have told us that they intend to publish it and give it wide circulation in Poland. Within the Bank, we plan to update and discuss the Country Strategy Paper before the end of August.

EFLari:nsp

cc: Messrs. Hasan (EMNVP), Nouvel (EM4), Harrison (EM4), Lav (EM4);
Ms. Loos (EM4).

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: July 13, 1987

NAME	ROOM NO.
Mr. Conable (o/r)	
(Through Mr. Stern)	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
x	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS: POLAND: Back-to-Office Report.

FROM:	ROOM NO.:	EXTENSION:
Eugenio F. Lari, EM4	H7065	32445

no need to see

1) MM

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 87/07/08 DUE DATE : 00/00/00
LOG NUMBER : 870714004 FROM : Lari,Dir. EMENA
SUBJECT : Poland: Back-to-Office Report.

OFFICE ASSIGNED TO FOR ACTION : 2) Mr. B. Conable (E-1227) o/r.

ACTION:

	APPROVED
✓	PLEASE HANDLE
	FOR YOUR INFORMATION
	FOR YOUR REVIEW AND RECOMMENDATION
	FOR THE FILES
	PLEASE DISCUSS WITH ______________
	PLEASE PREPARE RESPONSE FOR ______________ SIGNATURE
	AS WE DISCUSSED
	RETURN TO ______________

COMMENTS :

to discuss with Mr. Conable

3) Chitra - Country File

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 8, 1987

TO: Mr. Wilfried P. Thalwitz, Vice President EMENA

FROM: Eugenio F. Lari, Director, EM4

EXTENSION: 32445

SUBJECT: POLAND: Back-to-office Report

1. My recent visit in Poland was characterized by a series of high-level meetings with the Authorities responsible for economic management (including the Prime Minister), during which they presented to the Bank mission a "Medium-Term Scenario" which represents a substantially strengthened and accelerated program of Economic Reform, compared to the program discussed with the Bank during the last several months. This program is to be followed in two months by a detailed, time-bound action plan for 1987-88. If the action plan is satisfactory, it could provide the basis for renewed active programs with the Paris Club members and the Commercial Banks, and for assistance by the IMF and the Bank.

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b) trade liberalization, an active exchange rate policy, foreign exchange auctions, and a revamping of the export incentives system;

c) domestic price decontrol, with increases in the overall level of prices and changes in their structure: in particular, a policy of systematic increases in energy prices will be pursued;

d) phasing out the central system of allocation of material resources;

e) reducing the role of the budget in the redistribution of the national income, in the context of an austere fiscal policy;

f) reform of the tax system in general and custom duties in particular;

g) reform of the banking system, in the context of a restrictive monetary and credit policy, with positive real rates of interest;

h) rationalization of the investment program, revising and tightening investment criteria and increasing the productivity of capital, with particular emphasis on short-gestation investment programs.

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4. During the discussions, I made clear that we would need to examine carefully the proposed programs and the following action plan, and stressed the importance of a credible and consistent set of actions in a proper sequence. I also indicated the urgency of substantial up-front action. Finally, I repeatedly stated that, if the Bank was to reach a positive conclusion regarding Poland's ability to regain its creditworthiness and actively consider lending operations, it was essential that the country secure support from the IMF, reach a mutually satisfactory arrangement with the Paris Club, and agree with the commercial banks on the restoration of their lending operations in Poland. Regarding the Paris Club, we discussed the possibility of Poland presenting to the Club in the near future its medium-term economic restructuring and external debt management program and resuming in the near future some debt service payments due to Club members. The Polish Authorities may wish the Bank to play an active role at the Paris Club.

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see an active Bank program in the country: they need the money and the advice, they hope for a catalytic role of the Bank vis-a-vis other creditors, and last but not least they want credibility for their programs. Their intentions seem serious and they show substantial agreement among themselves. However, the systemic resistance to an effective implementation of the program should not be underestimated. We intend to continue the dialogue and preparation of possible projects in close contact with the IMF (a mission of which was also in the field while I was there) as well as with the Paris Club and the commercial banks.

7. We plan to circulate the first CEM on Poland to the Board in August. The Authorities have told us that they intend to publish it and give it wide circulation in Poland. Within the Bank, we plan to update and discuss the Country Strategy Paper before the end of August.

EFLari:nsp

cc: Messrs. Hasan (EMNVP), Nouvel (EM4), Harrison (EM4), Lav (EM4);
Ms. Loos (EM4).

FORM NO. 75
(6–83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: July 6, 1987

NAME	ROOM NO.
1. Mr. Thalwitz, EMNVP	
2. Mr. Qureshi, SVPO	
3. Mr. ~~Conable~~ / Mr. Wang	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
x	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS: POLAND--My recent visit.

FROM:	ROOM NO.:	EXTENSION:
Eugenio F. Lari, EM4	H7065	32445

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 6, 1987

TO: Mr. Barber B. Conable

THRU: Messrs. Qureshi, SVPO and Thalwitz, EMNVP

FROM: Eugenio F. Lari, Director EM4

EXTENSION: 32445

SUBJECT: POLAND

1. I have just returned from a brief visit to Poland where I met with the Prime Minister, several key economic ministers and the Governor of the Central Bank--and of the World Bank--Professor Baka.

2. The reception was exceedingly good and we were given a very promising medium-term economic restructuring program, to be followed at the time of the Annual Meeting by a detailed, time-bound action program for the next two years, with substantial up-front actions. The IMF, the World Bank, the Paris Club and the commercial banks would all play a role in supporting this program.

3. The Prime Minister, Mr. Zbigniew Messner, reiterated the Government's invitation for you to visit Poland at your earliest convenience. Provided Bank-Poland relations evolve constructively as it now appears possible, you may wish to include Poland among the countries you plan to visit in 1988.

EFLari:dh

cc: Messrs. Hasan (EMNVP), Nouvel (EM4)

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

March 17, 1987

Dear Mr. Prime Minister:

I greatly appreciate your invitation to visit Poland. During the past 10 months I have followed with interest the strengthening of our relationship. As we learn more of your objectives, development constraints, and needs, we are better able to define concretely the ways in which we could support your economic development program, and, in particular, the large scale transformation of Poland's economy to which you refer. In this context, Professor Baka's visit was quite opportune to discuss the prospects for long term collaboration, and the program for the months ahead.

I am also interested to learn of your concerns to improve international economic relations. There is, indeed, much that remains to be done by the international community to foster the kind of economic development we hope to achieve.

With a view to learning more of your concerns in these areas and to exchanging views on appropriate measures to be pursued, I would look forward to accepting your invitation. While a number of obligations prevents my proposing a precise schedule at this time, I shall communicate to you in the near future so that a mutually convenient date can be arranged.

Sincerely,

Barber B. Conable

Mr. Zbigniew Messner
President of the Council of Ministers
Office of the Council of Ministers
Al Ujazdowskie 1/3
00-583 Warsaw
Poland

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

RECEIVED DATE : 87/02/26 DUE DATE : 87/03/18
LOG NUMBER : EXC870312030
SUBJECT : (PROF. BAKA) FORMAL INVITATION TO BBC TO VISIT POLAND.
LETTER WAS HANDED TO BBC DURING THEIR VISIT ON FEB. 26.
OFFICE ASSIGNED TO FOR ACTION : (2) MR. WAPENHANS (H12-071)

ACTION:

	APPROVED
	PLEASE HANDLE
	FOR YOUR INFORMATION
	FOR YOUR REVIEW AND RECOMMENDATION
	FOR THE FILES
	PLEASE DISCUSS WITH
✓	PLEASE PREPARE RESPONSE FOR BBC's SIGNATURE
	AS WE DISCUSSED
	RETURN TO

COMMENTS : A coin set and book of Polish currency was given to BBC during the Feb. 26 meeting by Prof. Baka.

BBC replied on 3/17 - 3/20/87.

Dear Mr. President,

Taking the opportunity of the visit of the President of the National Bank of Poland, Professor Władysław Baka, to the World Bank, I would like to cordially invite you, Mr. President, to pay a visit to Poland.

The Government of Poland attaches a large importance to its resumed participation in the activities in the World Bank.

On the one hand in line with other countries at the same level of development, we intend to benefit from the Bank's financial resources. Since Poland is currently engaged in a large scale transformation of her economy this aspect of our cooperation is of particular importance. The Bank could play a major, supportive role in this process and therefore its undertakings in Poland are of such a significance.

On the other hand, we are interested in the presence of the World Bank and of yourself personally, in the various areas of the international economic relations. These relations leave much to be desired today. For Poland, a medium size country, highly dependent on conditions, of the world economy, this state of affairs is a subject of a serious concern.

I am convinced that your visit to Poland would have a significant impact on these both aspects of the cooperation between the World Bank and Poland. I trust therefore that you will be able to visit us at a convenient for you, early date.

With my respects,

0 ~~BASC~~ (KYI)
2 cp- file
(Copy given to IS)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 27, 1987

TO: Memorandum for the Record

FROM: Philippe Nouvel, Division Chief, EM1DA

EXTENSION: 32474

SUBJECT: POLAND - Meeting of Mr. Conable with Professor Baka, President of the National Bank of Poland and Governor for the World Bank--February 26, 1987

Attendance

Bank	Poland
Mr. W. A. Wapenhans	Prof. W. Baka, President, National Bank of Poland
Mr. E. F. Lari	Mr. G. Wojtowicz, Director, Foreign Department, National Bank of Poland
Mr. P. Nouvel	Mr. J. Boniuk, Financial Counsellor, Embassy of the Polish People's Republic
Mr. I. Sam	Mr. Czakanski, Director, Bureau of International Economic Cooperation, Office of Council Ministers
	Mr. A. Olechowski, Adviser to the President, National Bank of Poland

1. Prof. Baka stated that, since joining the Bank last July, Poland had benefitted a lot from renewed membership, in particular through the preparation and discussion of the first economic report. Poland wished to establish a solid and reciprocally-beneficial relationship with the Bank, as a recipient of the Bank's technical and financial assistance and as a shareholder. Prof. Baka mentioned his authorities' decision to join IDA and IFC soon, and their desire to subscribe their total share entitlement as soon as feasible.

2. The most immediate and important issue, according to Prof. Baka, related to the Bank's assistance and support to the preparation and implementation of a medium-term recovery program for Poland. Prof. Baka went on to explain the main features of that program, which would aim at developing a credible and sustainable path for Poland to restore satisfactory growth and

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Cleared with and cc: Mr. Lari (EM1)

cc: Mr. Conable's Office

cc: Messrs. Stern (SVPOP); Wapenhans (EMNVP) balance its external current account (probably by 1990) through improved export performance and restructuring of its economy, and progressive use of market forces in the general framework of the Polish reform program.

3. Prof. Baka noted the severity of Poland's debt problem--its debt in convertible currencies was more than five times its exports in such currencies, and Poland's access to external credit was practically nil, and stressed that his country's determination to meet its external obligations. However, he said, there was some lack of understanding among Poland's creditors--current and prospective--and the speed and success of the recovery program was dependent upon improvements in that area, and provision of external support for the implementation of the program.

4. The Polish Government believed that the World Bank's assistance would be of great help in the above areas. Prof. Baka understood the necessity of close coordination between the World Bank and the IMF, to support Poland's efforts to create the framework to restore external equilibrium and sustained growth in the future. He went on to propose a scenario according to which IBRD financial and technical assistance would, in the next year, assist Poland in modernizing its industry and eliminating bottlenecks to boost export performance, while at the same time Poland would prepare with the Bank and the IMF's assistance a satisfactory medium-term adjustment and development plan. In parallel, Poland would discuss with the IMF, and agree on, the conditions and framework for a standby to be put in place in 1988/89. This would pave the way for debt restructuring and provision of new external finance from commercial banks. He proposed that the Bank would accompany these efforts with structural-adjustment types of operation. Prof. Baka hoped the IBRD could, during FY88, provide $250-300 million to finance projects aiming at debottlenecking and modernizing export-oriented or import-savings industries, which he hoped could be presented to the IBRD Board around the end of 1987. He again stressed the importance of the Bank's assistance not only as a lender but also as a provider of technical assistance and as a catalyst vis-à-vis other financiers.

5. Mr. Conable emphasized the importance of the Bank and Poland agreeing on a credible medium-term program that would provide a solid basis for sustainable recovery and growth. Such a program was a precondition for Bank--and IMF--financial assistance, and the Bank would be pleased to assist Poland in designing it. He also stressed that the IMF and the Bank had to coordinate closely in that matter and that, in ultimate analysis, the restructuring and recovery program should be and clearly be seen to be the Polish Government's program.

6. Mr. Wapenhans noted that Prof. Baka had correctly reflected the substance of the discussions and tentative agreements reached during his visit. He also noted that the first important next step was the discussion with the Poles of the Bank's economic report, scheduled for next April/May. Appraising projects for IBRD financing towards the end of 1987 was possible, but the target of presenting them to the Board by that time was very ambitious.

7. Mr. Conable reiterated the need for close cooperation between the Polish Government, the IMF and the Bank, and inquired about the outcome of Prof. Baka's discussions with the IMF. He also stressed the importance of the Bank and Poland further developing their institutional relationship, and inquired about the status of Poland's representation on the Bank's Board.

8. Mr. Baka confirmed his understanding of the necessity for a close collaboration between the IMF and the Bank. The next IMF mission to Poland was planned for May. He noted that, although the IMF and the Bank had different mandates and objectives, their views regarding Poland's economic situation and prospects were broadly similar. Regarding Poland's representation to the Bank's Board, he noted that there were ongoing discussions with a few countries, mainly Italy. However, these discussions had not yet resulted in a final agreement for Poland's representation. In the meantime, and following discussions with Mr. Thahane, it had been agreed that an office would be secured for a Polish staff member to be paid by the Polish Government.

9. Mr. Conable noted these developments and reiterated the Bank's willingness to assist Poland in developing its recovery program. He stated that the Bank's assistance had to be built on a gradual approach, starting from a good understanding of the Polish situation and prospects, and building up progressively to eventually permit the Bank to commit financial resources for Poland, thereby supporting the Polish Government's own efforts, plans and programs.

10. Prof. Baka thanked Mr. Conable, and reviewed the next steps in the program of cooperation with the Bank, namely the discussion of the Bank's economic report, the forthcoming missions to do both sectoral analysis and project preparation, and the assistance to the preparation of the medium-term recovery program. Assuming these steps would demonstrate a good understanding and general agreements between the Bank and Poland, and also with the IMF, he reckoned--based on his discussions with both the IMF and the Bank--that the Bank could then consider proceeding with lending to Poland without necessarily a formal standby agreement with the IMF being signed. Mr. Conable confirmed that Prof. Baka's understanding was correct, but stressed that, while a formal agreement with the IMF was not a prerequisite, there had to be a firm plan based on agreed plans and actions to arrive at such an agreement, for the Bank to be able to start investing in Poland.

11. Before the meeting adjourned, Prof. Baka extended a formal invitation by the Prime Minister of Poland for a visit by Mr. Conable to his country.

PNouvel:mh

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FORM NO. 709
(8-84)

2-291
2/26/87

THE WORLD BANK/IFC

ROUTING SLIP	DATE: Feb. 26

FROM THE REGIONAL VICE PRESIDENT

NAME	ROOM NO.
Mr. Conable	
(through Mr. Stern)	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	COMMENT		PER OUR CONVERSATION
	FOR ACTION		PER YOUR REQUEST
	INFORMATION		PREPARE REPLY
	INITIAL		RECOMMENDATION
	NOTE AND FILE		SIGNATURE

REMARKS:

POLAND: Meeting with Prof. Baka

FROM:
W.A. Wapenhans, EMNVP

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 26, 1987

TO: Mr. Barber B. Conable, President

THROUGH: Mr. Ernest Stern, Senior Vice President, SVPOP

FROM: W. A. Wapenhans, Vice President, EMENA

SUBJECT: <u>Your Meeting with Professor W. Baka</u>

1. We met with Professor Baka and the Polish delegation and wish to bring to your attention the following main points during the discussion.

2. The Poles understand the importance of developing a coherent macroeconomic program and financial plan to restore Poland's creditworthiness, giving the highest priority to restructuring for exports, balancing the current account as soon as possible--but probably not before 1991--and then generating surpluses for renewed growth. In that context, Prof. Baka noted, however, that this would be very difficult to achieve if it implied a reduction of consumption, as real incomes now were 12 percent below the levels of 1979. He also noted their difficulty to prepare such a program--and to sell it domestically--in the absence of indications about possible accompanying support from the IMF, the IBRD and other external financiers.

3. In that context, Professor Baka mentioned the important role that the IBRD could play not only as a direct-lender but also indirectly to support the preparation of such a program, and its catalytic role vis-à-vis commercial banks and the Paris Club. We understand that he may formally request the Bank's--and the Fund's--assistance in the preparation of the design of the medium-term recovery program, and we would recommend to agree on such assistance--<u>provided</u> the Poles come forward with an initial proposal and scenario including a set and sequence of necessary policy measures. We understand that the Fund might also accept such request under the same condition.

Lets tone this down. our influence on the Polish debt and creditors is likely to be very modest.

4. We understand that discussions with the IMF also focussed on the need to get this program and action plan, which would be a precondition for the IMF considering a standby. A particular difficult point arose during their discussion, namely that the IMF--Mr. Camdessus himself--insists on the Poles presenting a program that would show a current account being in balance at the end of the year in which the standby would be granted, which the Poles consider unachievable even if consumption were to be cut. The Poles believe that two to three years are needed to restore the external balance.

I think there is a high probability that the action plan we and the Fund have in mind are very different ones.

Cleared with & cc: Mr. Lari (EM1DR)

cc: Ms. Loos (EM1)

PNouvel/mh:mct
2000G

5. Realizing this problem, the Poles are now thinking of a possible scenario according to which:

(a) The medium-term program would be prepared with assistance from IBRD and IMF.

(b) On the basis of this agreed program, the IBRD would start lending--in FY88--to support export improvements.

depends on our creditworthiness assessment and how much of the reform program has been put in place

(c) The IMF standby would come later--say in 1988-89--and would be accompanied or immediately followed by multi-year debt restructuring and new funding from commercial banks. (Yearly rescheduling on both public and private debt would have to continue before that time, which seems possible but would necessitate an improvement in the relationship between Poland and the Paris Club.)

6. This proposal should be discussed with the IMF and further in Poland, as it would imply that Poland could survive another year or two without major financial support from external financiers. Informally, the Polish delegation has indicated that this should be acceptable domestically.

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

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PNouvel/mh:mct
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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Barber

2 points to keep in mind

a) Poland is not now creditworthy for Bank lending. Reform is a prerequisite to improved creditworthiness

b) Sector adjustment is important, but we neither can nor should start with a new borrower with quick disbursing loans.

Ernie 2/25

DATE: February 24, 1987

TO: Mr. Barber B. Conable, President

THRU: Mr. Ernest Stern, Senior Vice President, SVPOP

FROM: W. A. Wapenhans, Vice President, EMNVP

SUBJECT: POLAND - Your Meeting with Prof. W. Baka, President of National Bank of Poland and Governor for the World Bank, February 26, 1987, 4:30 PM

Arrangements

1. Prof. W. Baka is the President of the National Bank of Poland; he previously was the Minister responsible for Economic Reform and is also the Governor for the Bank for Poland. He commands considerable influence within the Government on reform issues and is one of the leading figures named by President Jaruzelski to the Consultative Social Council to advise him on issues of social policy. The National Bank of Poland was assigned by the Government the responsibilities as the main interlocutor with the Bank. Prof. Baka was not able to attend the 1986 Annual Meetings (the first attended by Poland since its resumption of membership in June 1986) and he therefore would like to meet with Bank senior management to establish contact and to consult on the Government's current plans and programs and how these relate to the possible program of support from the Bank. In addition to meetings in the Bank, Prof. Baka will meet with Mr. Camdessus and IMF officials. During his stay in Washington, he will also meet with officals in the US State Department and Mr. Volcker at the Federal Reserve Board.

2. Prof. Baka speaks fluent French, and his English is improving fast. He will be accompanied by three other officials from Poland--Mr. Czakanski, Director of the Bureau of International Economic Cooperation in the Office of the Council of Ministers; Mr. Wojtowicz, Director of the Foreign Department of the National Bank of Poland, and Mr. Olechowski, Adviser to Prof. Baka (and a former World Bank staff member in the Development Research Department), who will also act as translator as needed. Mr. Boniuk, Financial Counsellor of the Polish Embassy in Washington, will also attend. Messrs. Lari and Nouvel and I will attend from the EMENA Region.

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cc: Messrs. Lari and Nouvel (EM1)

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3. In addition to a series of meetings with EMENA staff, we have also arranged for the Polish Delegation to meet with Messrs. Qureshi, Baneth, Willoughby, Feather, Gustafson and Dyck. Prof. Baka will also meet with Mr. Thahane to discuss organizational matters related to the operations of the Board and the shares of Bank stock allocated to Poland. As you know, Poland is still not represented by an Executive Director on our Board, and Prof. Baka is also seeking contacts with at least one European constituency during his visit. Prof. Baka has also indicated that he is prepared to give a presentation on the Polish reform program, and a small seminar has been arranged for interested Bank staff on Thursday, February 26 at 9:30 am.

Background and Recent Developments

4. Since the time of the 1986 Annual Meetings, we have discussed our first special economic report with the Polish authorities and are in the process of completing the internal draft of a full Country Economic Memorandum (CEM). In these reports we examine the current Five Year Plan (1986-90) and explore possible alternatives to some of the key assumptions, particularly those related to external accounts. While the current Plan forecasts a continuation of growth during the second half of the 1980s, allowing the economy to restore investment and consumption to their pre-crisis levels by the end of the Plan period, it is also based on the assumption of no change in Poland's economic relations with the convertible currency area (i.e., no new credits), a stagnant trade surplus and therefore worsening current account deficit with the convertible currency areas, and improved financial relations with the CMEA.

5. The Polish authorities have indicated in our initial meetings this week that they too find the Plan unsatisfactory and look forward to further consultations with the Bank on ways to establish a more suitable basis for economic recovery and restructuring. We are pleased to note that the Government is already moving on a number of important issues, including the devaluation of the zloty by 40% since September 1986, reducing subsidies, increasing energy prices, and improving incentives to export. We anticipate that the discussions of the CEM will provide the basis and agenda for our dialogue with the Government on its economic reform programs and creditworthiness. We hope the analysis and discussion will help in the formulation of an economic program which would: (i) serve as the basis for IMF assistance; (ii) be acceptable to Poland's creditors; and (iii) justify Poland's creditworthiness for Bank lending. We have also initiated some preparatory work to identify and commence preparation of possible lending operations, on the assumption that a program to promote medium-term creditworthiness can be agreed upon and the Bank would be able to start lending in late FY88. Whether the Government's reform programs are sufficient for us to consider policy-based lending at an early date remains doubtful. It is more likely that early emphasis in our lending operations may be placed on enterprise rehabilitation and modernization within an export-oriented support program.

not doubtful, at all. There is, at present, no such prospect and you should not indicate otherwise.

6. The IMF has undertaken extensive work on Poland within the last 18 months, including the basic analysis for the calculation of quota and the first Article IV consultation. Mr. Whittome visited Poland in January this year, but did not find sufficient progress towards establishing the basis for an IMF operation at this time. Nevertheless, discussions continue and Prof. Baka may bring some messages that would cause the IMF to begin work towards a program, including a further IMF mission in the spring of 1987.

7. The latest Paris Club discussions also failed to yield a satisfactory outcome. The Government's medium-term projections are obviously as unsatisfactory to the official creditors as they are unacceptable to the IMF and the Bank. Moreover, the official creditors have some justification in their view that commercial banks are currently being treated relatively favorably at the expense of the official creditors. On the other hand, the Poles have resisted disturbing a pattern of rescheduling with commercial banks that persisted relatively smoothly through the period of most severe economic sanctions and the refusal of the Paris Club to discuss rescheduling at that time. Recent political developments are promising, with the remnants of sanctions applied by the US being lifted last week. While this step in itself is not a major economic factor, it does indicate that the US may now be able to be more supportive in helping the Paris Club to come to better understandings with Poland.

Suggested Agenda

8. As Prof. Baka's meeting with you will come near the end of his visit to the Bank, we will provide an update on any matters crucial to your discussions and/or changes in the suggested agenda prior to your meeting. The Polish officials have indicated that Prof. Baka would like to discuss with you Poland's external financial position and forecast for the rest of the 1980s and Polish views on the scope for cooperation with the Bank, including new fields and forms such as environmental protection, IFC-led joint ventures (note that Poland is not yet a member of IFC), and possibilities for sectoral adjustment loans.

9. We would ask you to emphasize two critical issues in your meeting: (i) the importance of a coherent macroeconomic program and a financial plan which show a credible path for Poland's medium-term recovery of creditworthiness; and (ii) the need to coordinate better and amplify the discussions with Poland's creditors about Poland's medium-term intentions and prospects and the role current creditors may reasonably be asked to play.

10. As noted at the time of the Annual Meetings, and unfortunately still today, the current version of the Five Year Plan offers a rather grim and pessimistic outlook, which does not provide a satisfactory framework for possible economic recovery and satisfactory management of the balance of payments. As you will note from the attachment, Poland is not in a position at present to meet all its external obligations and its external financing needs are such that they cannot possibly be met from IMF and IBRD operations alone, even if that could otherwise by contemplated. Without a credible medium-term scenario including a timetable of reform measures for the recovery of creditworthiness over time, it is highly unlikely that Poland's Western creditors would contribute to the re-financing of the existing burden of debt, let alone provide additional resources in support of long-term development objectives.

11. The Polish Government is also not very effective in making a coherent approach to its creditors. Relations with the commercial banks are handled mainly by the Foreign Trade Bank, whereas those with the Paris Club are managed by the Ministry of Finance. Not only does this create the perception of discrepancy of treatment of the two groups, it also carries the danger of different positions and prospects being advanced and thus failing to generate a consensus and understanding best suited to promote Poland's long-term advantages and opportunities. You may wish to inquire how the Polish authorities intend to handle these matters in the future (particularly if there is a more forthcoming position on the Plan and a potentially viable path for recovery of creditworthiness is developed) and in what way the Bank may facilitate this process. A sensible rearrangement of Poland's external debt clearly is an integral and important component of any program to restore creditworthiness. You should underline that for the Bank to start lending operations on any significant and continuing scale would require that Poland had secured access to IMF facilities and was on the way to reestablishing access to the convertible currency capital market. We see an important role for the Bank in this process, being a catalyst, especially in relation to the latter.

Attachment

Poland

Background Summary

1. Structure of the Economy. The Polish economy is large and diversified. It has a population of over 37 million, growing at a rate of 0.8%; 60% live in urban areas. Per capita GDP in 1984, utilizing the World Bank Atlas methodology, was $2100. The socialized sector of the economy contributes more than 80% of gross material product [1/] and employs over 70% of the labor force. Two-thirds of the remaining output, generated by non-socialized (or private) sector, originates in agriculture, with the balance being distributed between small industrial and construction firms. The Government budget encompasses about 42% of GDP and remains in deficit (although this deficit has been reduced significantly from over 11% of GDP in 1981 to slightly more than 1% in 1985). However, the conventional measure of budgetary deficits understates the real deficit, as the Government has assumed the foreign exchange risk on all foreign debt, thereby incurring a major loss from its policy of pursuing an active foreign exchange policy over the past four years, including a series of major devaluations. Monetary stock has been rising in recent years at a rate of 23% (due in part to the total monetization of the Government deficit) and open inflation is currently about 17%.

2. About 29% of the labor force of 17 million is engaged in industry, including mining and energy; almost as many are in agriculture. The former, however, produces 49% of national output and the latter only 16%, indicating a large disparity in productivity. Industry is heavily concentrated; enterprises employing over 1000 workers account for over 67% of industrial employment and industrial output. Only about 12% of total sales of the industrial sector are exported. The structure of manufacturing is strongly biased towards heavy industry; electro-engineering accounts for a third of industrial employment and a quarter of industrial output. Poland is the world's fifth largest producer of hard coal and a net energy exporter in physical volume terms; it is investing heavily in energy production to maintain output at present levels. Domestic energy use is lavish and, compared to both world prices and marginal costs, is heavily subsidized; in contrast to most countries, energy use has been growing at the same rate as national output.

3. More than half of agricultural production comes from crops, with the remainder from livestock; only about 5% of agricultural production is exported. About 75% of agriculture is in private hands, whether measured by land area or output. Many holdings are very small--two-thirds are below 7 ha. Years of discrimination against private agriculture were formally ended by a 1983 constitutional amendment guaranteeing its permanence and the Government has committed itself to a policy of income equality between farm and non-farm sectors. As this program is based on the finances of a

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[1/] The system of material product used by most Eastern European countries differs from the system of national accounts used by the Bank in that it does not include housing, education, health, cultural services, public administration, defense, finance or insurance.

relatively small size farm (6.7 ha), to achieve income parity requires that agricultural procurement and input prices be set at levels which imply a very high level of protection (at present exchange rates) and budgetary subsidization.

4. Total exports of goods and non-factor services were equivalent to only about 17% of GDP in 1985 and imports were about 16%. About half of this trade is with CMEA (COMECON) countries, of which 60% is with the Soviet Union, and is denominated in transferable rubles (TR). Exports to CMEA countries are dominated by engineering products, and these are also major imports, along with raw materials and fuels (oil and natural gas account for 30% of Poland's imports from the CMEA). Roughly 40% of Polish trade involves genuinely convertible currencies. The remaining 10% derives from bilateral clearing arrangements, denominated in convertible currencies. Coal is the largest export to convertible currency areas (i.e., including the clearing arrangements) and amounted to about 23% of all exports to convertible currency areas in 1985, followed by engineering (18%) and metallurgy (12%). Food and agriculture, engineering products, and chemicals are roughly equal in importance as convertible currency imports.

5. Crisis in Early 1980s. The economic and political crisis of the early 1980s had its roots in the early 1970s, when a radical change of policy led Poland to undertake a program of economic modernization that relied heavily on imports of Western capital equipment and technology, financed by foreign credits. At the same time, in order to defuse social tensions and promote higher labor productivity, wage restraints were relaxed. An extremely rapid growth in investment and consumption ensued during 1971-75 which outstripped the increase in output, was accompanied by an unprecedented upsurge in the volume of imports from convertible currency areas, and gave rise by the middle of the decade to a current account deficit in convertible currencies equivalent to nearly 10% of GDP.

6. In attempts to stave off a crisis, the Government took a number of measures in the late 1970s to constrain the growth of investment and output. Stock accumulation began to fall in 1977 and fixed investment in 1978; by 1982, total investment was cut to only half its 1977 peak. Attempts to curb consumption growth by raising prices were resisted, and consumption continued to rise until 1980. The rate of growth of output slowed, and turned negative in 1979 for the first time in the post war period. Successive years of poor harvests led to increasing trade deficits in food and agriculture. Although the trade deficit in 1977-79 was reduced to about 2 billion dollars a year, this modest improvement was largely offset by the rising interest burden. External debt (which had been US $1.1 billion in 1971 and $12 billion in 1976) reached $24 billion in 1979. By 1980, the country devoted 96% of its convertible earnings from exports of goods and non-factor services to debt service. In that year, new medium- and long-term borrowing financed 84% of imports of goods and non-factor services.

7. The economic situation weakened rapidly in the opening years of the 1980s; domestically a growing conflict between the trade union movement and the Government lead to significant losses in output and exports. Externally, capital inflows fell precipitously. To face these mounting economic issues and the political challenge of the free trade unions, the Government declared Martial Law in December 1981 and launched a major stabilization program.

Under the stabilization measures (and also on account of economic disruption), total output in 1982 fell to only about 76% of its 1978 level. By 1983 the Government froze or abandoned projects with a value of over one-third of the socialized sector fixed investment undertaken in 1981-83. By 1982 consumption fell 14% below its 1980 peak. Despite the fact that convertible currency exports fell to only 8% of GDP, Poland achieved a substantial trade surplus with the convertible currency areas ($1-1.5 billion) starting in 1982 by severely constraining imports. The reduction of agriculture's net trade deficit from $2.5b in 1981 to $200m in 1985 was a major element in this achievement.

8. The deterioration of economic conditions was sharp, and the recovery from the crisis has been gradual. Output resumed growth in 1983 (achieving rates of 6%, 5.6%, 3%, and estimated 4-5% respectively in the 1983-86 period). Despite this progress, output reached only about 90% of its 1978 level by end 1986 and fixed investment was still about 25% below its 1978 level.

9. External Debt. Facing debt service requirements that were clearly unmeetable (eventually debt service due was 155% of 1981 exports of goods and non-factor services), Poland obtained agreement in April 1981 through the Paris Club on the rescheduling of 90% of its obligations to Western official creditors falling due in the last three quarters of 1981. A special consortium of commercial banks (the London Club) was formed and agreed to reschedule unmet 1981 and 1982 maturities. Western official creditors broke off talks with Poland during the 1982-84 period, during which time Poland made no payment to its official creditors.

10. Martial Law was lifted in 1983 and Western creditors resumed debt discussion with Poland; only in July 1985 was a new agreement signed covering 100% of the 1982-84 maturities and delayed interest. Similar arrangements were made subsequently for 1985 and 1986 maturities. Bank reschedulings continued regularly during this period, with Poland paying full interest and a small portion of principal. No new term lending has been provided to Poland since 1982, although the banks have made available a small trade credit facility out of recycled interest payments (currently about $800 million, or less than 20% of imports).

11. In spite of these repeated reschedulings, and the failure of Poland to meet her interest obligations in full, Poland has devoted a substantial proportion of her export earnings to debt service. Debt service paid as a percentage of exports of goods and non-factor services in convertible currency was 63% in 1981, 43% in 1982, 37% in 1983, 27% in 1984, 44% in 1985, and 33% in 1986. Some modest repayments since 1981, and in many cases reimbursement of banks under various official guarantee programs, have led to a substantial reduction in commercial bank exposure. In contrast, official debt has tended to increase, partly because more of the debt originally classified as unguaranteed turned out to have official guarantees, and in part because of the capitalization of accumulated interest arrears, and interest on late interest, since 1982. Of the some $34 billion owed to Western creditors at the end of 1986, about $20 billion was to official creditors, making Poland one of the largest debtors to the Paris Club. The crux of the debt issue lie in the facts that Polish convertible currency debt is not large when related to output (40% of GDP) but is large when related to convertible currency trade (over six times its annual convertible currency exports).

12. Recent Policy Developments. A program of economic reform introduced in 1982 caused the economic system to depart quite a long way from a traditional centrally-planned economy. The blueprint for the reform is a fairly radical version of market socialism--in most ways as advanced as the present stage of the Hungarian reform. The reform attempted to: (i) increase autonomy and accountability of enterprises as a means to increase the recognized low material and labor efficiency of the economy, and (ii) streamline centralized management to work by indicative planning and policy prescription rather than by direct command. The legislative and institutional changes were accompanied by a considerable reduction in subsidies, a major simplification of the exchange rate system, and the introduction of a progressive levy aimed at containing wage increases and relating them to increases in in productivity. But the introduction of the reform at a time of crisis inhibited the central authorities from relaxing control over the allocation of key inputs. Enterprise autonomy is still restricted in other ways as well, and their activities remain largely guided by the relevant branch ministry. Foreign exchange allocation is still tightly controlled. Many prices are still regulated, often on a cost-plus basis. Opportunities to declare enterprises bankrupt are taken only rarely--they are more often kept going with subsidies and tax exemptions.

13. The Five Year Plan (1986-90) envisages that material output should increase by 16-19% over the Plan period, about 3.0-3.4% per year, and would approximate its 1978 level by 1990. Investment is projected to increase at a rate slightly faster than total output, and consumption slightly slower. This would bring investment back to its 1980 level by the end of the Plan, which is still well below what it was in 1977. The achievement of the upper end of the range of alternative consumption projections would bring per capita consumption in 1990 back to its 1980 level.

14. The Plan is based on the assumption of no change in Poland's economic relations with the convertible currency areas (e.g., no new credits). The export projections assume a rate of convertible currency growth in volume averaging 3.7% a year; import growth from the same area is assumed to average 4.5% a year. Some year-to-year variation in growth rates is assumed to permit the average trade surplus in convertible currencies to remain more-or-less constant at $1.3--$1.4 billion. The resulting current account balance, however, worsens slightly. The official projection shows that the debt service ratio (due) would rise to 84% by 1990, while the ratio that Poland would actually pay would fall from about 30% to 25% over the period. Contrary to the pattern with the convertible currency areas, financial relations with the CMEA area undergo a substantial improvement. Current projections call for Poland to stop running a trade deficit with the CMEA area, generate a current account surplus and begin to repay CMEA debt by the end of the Plan.

15. Extrapolating current patterns into the 1990s shows an increasing debt service burden in convertible currencies and a widening gap between debt service owed and the amount that Poland is able to pay. Even this gloomy projection could not be described as secure. In 1985, convertible currency exports fell by 3.6% in volume and results in 1986 do not appear to counter this trend. This reflects domestic absorption of coal meant for export, but also diminishing competitiveness for other exports, especially engineering. If these trends were to continue throughout the Plan period, without a change in other Plan forecasts, the debt service ratio in convertible currencies would again exceed 100% in 1990, and the trade surplus would disappear by 1992. The official scenario incorporated in the Plan is headed more slowly in the same direction, and therefore is not sustainable as a long-run proposition.

The World Bank

OFFICE OF THE PRESIDENT Date 2/12/86

BBC 2

JWS

Judith

Isaac 1

Vivek

Linda

Jenny

Chitra

REMARKS B—

JS says when it breaks it will move fast - perhaps you want to do as suggested on page 3.

L—

FORM NO. 709
(8-84)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: 2/10/87

FROM THE REGIONAL VICE PRESIDENT

NAME	ROOM NO.
Mr. B. Conable	
RE: Poland	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	COMMENT		PER OUR CONVERSATION
	FOR ACTION		PER YOUR REQUEST
	INFORMATION		PREPARE REPLY
	INITIAL		RECOMMENDATION
	NOTE AND FILE		SIGNATURE

REMARKS:

The attached is for information only. Separate briefs will be prepared for the visit later this month of the Polish Delegation led by Mr. Baka, President of the National Bank and our Governor. You will recall that Poland is not yet represented by an Executive Director on our Board.

W. A. Wapenhans

FROM:

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 6, 1987

TO: Mr. W. A. Wapenhans, Vice President, EMENA

FROM: Eugenio F. Lari, Director, EM1

SUBJECT: POLAND: Recent Developments

1. In the past few weeks, there has been considerable activity on the Polish economic/political/diplomatic front. A rejection by the Polish Parliament of some proposed modifications to the enterprise management system, a procession of visitors to Poland, Mr. Jaruzelski's visit to Italy, a Paris Club meeting and a further substantial devaluation have caught Press attention. It might be useful therefore just to summarize briefly the key developments since the Economic Mission's back-to-office report in early December. Perhaps I should note at the outset, however, that while the net result of these events appears to be neither any major breakthrough nor serious setback the overall trend seems positive. The conclusion of the First Report, reiterated in the December back-to-office report still stands: that an economic program for Poland--which would serve as the basis for Fund assistance, be acceptable to her creditors, and justify her creditworthiness for World Bank lending--ought to be within Poland's reach but has not yet been developed.

Domestic Developments

2. The principle behind Polish economic reform is to allow the price mechanism to determine the allocation of resources. There have been two major obstacles to this. The first is that domestic prices are considerably out of line with relative scarcities, especially if the possibilities for international trade are taken into account. The second is widespread excess demand, reflected in waiting lists, queues, forced savings and sellers' markets. The Economic Mission was told that the Government was proposing some fairly radical steps to overcome these problems in 1987-8--a major cut in subsidies, especially for energy, a series of devaluations to reduce the real exchange rate, and a cap on wages at below the inflation rate to reduce internal excess demand. In the more radical of two alternative courses proposed, Poland's inflation rate, which has been in the 15-20% range for some years would more than double in 1988, but would go back to single figures in 1990. Less dramatic attempts at price adjustments brought down previous Polish administrations in 1958, 1970 and 1980, and had to be reversed in 1976, but this time the aim is to obtain a social consensus.

Cleared with & cc: Mr. Nouvel (EM1DA)

cc: Messrs. Dervis (EMNVP); Harrison, Lav, Ms. Loos (EM1)
TKing:tr
2128G

3. The Polish authorities believe that an attempt to obtain a one-time boost to the inflation rate without perpetuating a spiral, in an economy characterized by excess demand needs a considerable degree of central control. This is one possible interpretation of the submission to Parliament of a proposed set of amendments to the economic reform legislation, whose net effect was to increase the powers of the (often centrally-appointed) enterprise directors vis-a-vis workers' councils, and which effectively permitted capping wage increases and introducing periodic wage freezes. After extensive Parliamentary and Press criticism, the proposals were withdrawn. Whether this should be interpreted as victory for enterprise autonomy, as most reformers appear to think, or defeat for the prospects of radical price and wage adjustments, as one might fear, is not certain. The Government's program in this respect appears unaltered, and was more or less explicitly announced by the Deputy Prime Minister Szalajda in a speech to the Party Central Committee in mid-December. I also understand that for 1987 wage increases have been effectively capped at a rate lower than that of expected inflation. There has been a further devaluation of the zloty, making for a total devaluation of one-third against the dollar (and much more on a trade-weighted basis) since September. Significant changes introduced in the regulations governing the export retention scheme should substantially reduce distortions in the allocation of foreign exchange. We do believe, however, that further devaluation of the zloty is needed and understand that the Government intends to do so.

4. One other potentially important internal development has been the establishment of the Consultative <u>Social</u> Council set up to advise Gen. Jaruzelski on issues of social policy. The Press has been a bit sceptical about the extent to which this is going to heal the breach between the administration and the population, especially given the refusal of the Church and most prominent Catholics to take part. But the previously established Consultative <u>Economic</u> Council has turned out to be surprisingly outspoken, and its Chairman of the CEC, Mr Bobrowski, is also a member of the new Council. It is also of interest to the Bank that Mr Baka--the President of the National Bank and Governor for the Bank who is going to visit us during the last week of this month--is a member of the new Council.

<u>International Developments</u>

5. Nothing very dramatic was expected from the recent visit to Poland of Mr. Whitehead, the US Deputy Secretary of State, although it is clearly one additional step in the process of normalization of US--Poland relationship. His meeting with Mr. Walesa may have underscored the fact that opposition and regime alike are calling for the normalization of commercial relations and a restoration of Poland's MFN status. The significance of this visit, and that of Gen. Jaruzelski to Italy, is that they occurred, and are clearly signs of improvement in Poland's international relations as is Mr. Nakasone's visit to Poland and Eastern Europe, which is also a reminder of the global nature of Japan's commercial concerns.

6. As was anticipated, the visit of Mr. Whittome and Mr. Hole from the Fund did not result in significant progress towards establishing the basis for an IMF operation. The basic trade and balance of payments forecasts enshrined in both the Five-Year Plan and the 1987 Plan have not changed. They show a worsening balance of payments picture in 1987, and very slow improvement indeed thereafter. The current account reaches equilibrium only in 1993. The situation, however, remains that a shift of only 1% of GDP into current account improvement could eliminate the deficit. We understand that Mr. Whittome made clear the unacceptability of the present projections as the basis for a Fund program. Nevertheless it was agreed that work towards a program would begin with a Fund mission sometime in the Spring.

7. The Paris Club discussions of the Polish debt also failed to yield a satisfactory outcome. The medium-term projections are obviously as unsatisfactory to the official creditors as they are unacceptable to the Fund and to ourselves, and Polish resources for debt service are projected to be smaller in 1987 than they were in 1986. Moreover the official creditors have some justification for their view that commercial banks are being relatively too well treated. At the start of 1986, Poland owed \$18b. to Western official creditors and \$6.6b. to Western Banks. Nevertheless, \$632m. was paid to the banks and only \$612m. to the official creditors. Poland remained current with the banks but fell increasingly into arrears with the Paris Club, a situation that is likely to continue in 1987. What Poland needs, in addition to a credible forecast of a more rapidly improving current account, is a proposal for debt management that would treat different creditors more equitably and point the way for some kind of long-term debt restructuring. The latter may be difficult to start in 1987, but it must be in everybody's interest to achieve it eventually, and the first step is to develop some realistic proposals of what this might mean. They may need some technical assistance on this.

8. You may wish to share this note with top management.

Mr. Conable

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: October 10, 1986

TO: Memorandum for the Record

FROM: Philippe Nouvel, Division Chief, EM1DA

SUBJECT: 1986 Annual Meetings: Mr. Conable's Meeting with the Polish Delegation - September 28, 1986, Washington, D. C.

Attendance

Polish Delegation:

HE Samojlik, Minister of Finance
Mr. Karcz, Director of the Foreign Department, Ministry of Finance
Mr. Wojtowicz, Director of the Foreign Department, National Bank of Poland
Mr. Pakula, First Deputy to the President, National Bank of Poland
Mr. Ilczuk, Deputy Director, Foreign Department, National Bank of Poland
Mr. Boniuk, Counselor (Financial Affairs), Embassy of the Polish People's Republic

The World Bank:

Mr. Conable
Mr. Stern (SVPOP)
Mr. Husain (OPSVP)
Mr. Wapenhans (EMNVP)
Mr. Lari (EM1DR)
Mr. Sam (EXC)
Mr. Nouvel (EM1DA)

1. Mr. Conable, after welcoming the delegation, said the Bank was keen on developing an efficient, fruitful program of cooperation with Poland.

2. The Minister of Finance congratulated Mr. Conable on his appointment as President of the World Bank and went on to say that the Polish authorities were also keen on developing a good cooperation with the Bank, to benefit from the Bank experience on both technical and economic matters, get its financial assistance and, through the Bank, broaden their contacts with the international community and institutions. Poland had enormous needs and difficult goals, and counted much on the Bank to help them achieve these goals. They had no past experience in dealing with IBRD but looked forward to establishing a solid relationship. Mr. Samojlik mentioned they had contacted Hungary to benefit from their experience in building up a relationship with IBRD.

Cleared with and cc: Mr. Lari (EM1)

cc: Mr. Conable's Office
Messrs. Stern (SVPOP), Husain (OPSVP), Wapenhans (EMNVP), Rajagopalan (EMPDR), Office of the Chief Economist, Office of the Cofinancing Coordinator (EMNVP), Sam (EXC), Dewey (EMPDR), Harrison, Moreau, King, Lav, Ms. Loos (EM1)

cc: for info: Mr. Dervis (INDSP)

PNouvel:mh
2088G

3. Mr. Conable said that clearly the Bank and the IMF would have to continue to coordinate closely in their relationships with Poland. He asked the delegation how they saw Poland's problems, and how they expected IBRD to assist in solving them.

4. Mr. Samojlik said they would discuss with the IMF their report on the Article IV Consultation shortly, and some possible program later. As far as IBRD was concerned, the next major step was the economic mission planned for end October, which should permit to broaden the discussion with the Bank on economic matters and at the same time refine the analysis and recommendation on specific priority areas. In that connection, Mr. Samojlik said that his government's priorities were to make the economy more efficient and export-oriented, in particular as concerns agriculture but also industry. In parallel, efforts would be made to develop energy conservation programs. To achieve these priorities, production capacity had to be modernized, with transfer of technology from the West.

5. Mr. Wapenhans commented there were indeed areas of priority, with export development being evidently the highest. He noted in that context that Poland's current programs and plans were unsatisfactory, as the overall projections did not indicate that the economy was on the path of recovery and reestablished creditworthiness. The Polish Government might want to focus on the development of plans and programs that would meet this objective, and IBRD would be pleased to assist in that matter--in particular during the next economic mission. Once such plans, programs and promotions have been established and agreed upon, IBRD could assist in this implementation with funds--most probably not before FY88. As regards industrial production and exports, technology was important but establishing a proper system of incentives was even more important.

6. Mr. Stern stressed the latter point, adding that a search for appropriate market outlays was also of importance.

7. Mr. Samojlik confirmed the Poles' keen desire to work with IBRD on these areas and to develop a long-term program of cooperation with IBRD which could include a search for industrial partners to develop joint ventures, some examples of which already exist in Hungary (aerospace, agricultural machinery).

8. Mr. Conable reaffirmed the Bank's desire to develop a long-term program of cooperation for the year ahead.

9. Mr. Pakula, on behalf of Mr. Baka (President of the National Bank of Poland and Governor for the Bank who could unfortunately not attend the meeting [1/]), extended an invitation to Mr. Conable to visit Poland. He added that Mr. Baka would come to Washington in the near future and would hope to meet with Mr. Conable. He also stressed the success of the procurement semi- nar recently held in Warsaw, which was a good omen for future cooperation. Mr. Stern commented that access to procurement under Bank financing had been among the major early benefits that Hungary had derived from its membership in the Bank.

10. The meeting then adjourned.

[1/] He is hosting a conference of COMECON institutions in Warsaw.

FORM NO. 1599
(8-80)

THE WORLD BANK

ROUTING SLIP

DATE 2/22

OFFICE OF THE SENIOR VICE PRESIDENT, OPERATIONS

NAME	ROOM NO.
Mr. Clausen	

	To Handle		Note and File
	Appropriate Disposition		Note and Return
	Approval		Prepare Reply
	Comment		Per Our Conversation
	Full Report		Recommendation
	Information		Signature
	Initial		Send On

REMARKS

Status of discussions with Poland.

Ernie

FROM

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

CONFIDENTIAL

DATE : February 18, 1986

TO : Files

FROM : Jane Loos, Sr. Loan Officer, EM1DA

EXT. : 32469

SUBJECT: POLAND - Meeting with Polish Delegation

2-24-86

1. Mr. Wapenhans met on Friday, February 14 with members of the Polish Delegation, which was visiting Washington to present their case to the IMF Membership Committee. The Polish Delegation was led by Mr. Z. Karcz, Director of the Foreign Department of the Ministry of Finance; a list of the other members of the Polish delegation is attached. Mr. Lari and I also attended.

2. Mr. Karcz explained that, as the arrangements for membership in the IMF and the Bank are nearing completion, his authorities were anxious to close off this phase and move on to one of normal cooperation and participation in IMF and Bank activities. He indicated that when the question of reentry into the IMF and the Bank was first being considered by the Polish authorities, they were operating under the perhaps mistaken assumption that the financial resources available via the IMF would be more significant that those from the Bank; now that they have learned more about Bank operations, and in particular about the experience of Hungary, they have come to a different understanding about these possibilities.

3. Mr. Wapenhans explained that, from an operational point of view, the process of membership was only a first step, and that much work needed to be done on the part of both the Polish authorities and the Bank to establish and develop a fruitful relationship. He reconfirmed that the Bank would send a full economic mission after membership is arranged to learn more about the current economic situation and prospects. This mission would evaluate some technical issues (e.g., calculation of GDP per capita, which is a starting point in establishing possibilities for lending), but its most important work

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Cleared with and cc: Messrs. Wapenhans (EMNVP); Lari (EM1)

cc: Messrs. Harrison, Nouvel, King (EM1) would relate to our dialogue with the Polish authorities on their development outlook, strategy and policies. Mr. Wapenhans indicated that the Bank would be interested in learning the Government's thinking about what lies ahead, not only for the stabilization, but also for the basic structural adjustment that appears to be necessary to resume growth.

4. Mr. Karcz explained that his authorities would welcome the economic mission, and would make available all information it may require. He offered to provide the mission with a preview of the Five Year Plan (1986-1990), which is still under preparation, including making available backup information on a sectoral and more disaggregated basis, as a Five Year Plan for Parliamentary review is necessarily in summary form. He also stressed the importance of consistency between the IMF and the Bank in the type of information, format, methodology, definitions, etc. required for the GDP calculations.

5. Mr. Karcz reviewed the recent developments in the Polish economy, explaining that the stabilization in the early 1980's was precipitated by an unsustainable policy on investment and consumption, which was remedied by strong measures -- cutting the standard of living by 25% and severe cuts in capital spending. Current policy continues this restraint on consumption, with all additional resources generated going back into the productive sectors. After ten years of deficits in the trade account with the convertible currency area, the Poles have managed to maintain a surplus since 1982. This was made possible through a severe restriction on imports, and not, unfortunately, by an expansion of exports. He was pleased to note that agricultural trade is now back in balance, as the result of cutting back consumption (imported grain and feedstock which had been linked to an artificially high standard of living and low administered producer prices) and increased domestic agricultural production (facilitated by higher producer prices and more investment in agriculture, plus good weather). He acknowledged that there are still some budgetary problems in the agricultural sector, as not all producer price increases are being passed promptly through to the consumers.

6. Mr. Karcz explained that his Government's strategy was now looking to restore capital spending in the most efficient manner, to facilitate the return to growth. Even during the stabilization crisis, some capital spending was maintained, such as energy production and inputs to agriculture (e.g., tractors and fertilizers). There was a second group of important projects which could not be continued due to lack of resources, but which they now would like to finish. There is also a third group of projects which are very important for restoring Polish competitiveness, through modernization of existing productive capacity to improve quality and energy efficiency. In the agricultural sector, he highlighted the need for investments in storage, transport and processing.

7. Mr. Karcz explained that what they were after was not just increased efficiency, but also structural change, citing the targets of the draft Five Year Plan. A 17% increase in industrial output, 35% increase in exports, with only a 0 - 4% increase in raw materials and energy, required not only increased material efficiency and new technology, but also increased financial efficiency and the continuation of the economic reforms initiated in the early 1980's.

8. Mr. Wapenhans explained that Bank missions would be following up on these broader issues not only as part of our economic dialogue, but also in the context of any future discussions of lending possibilities, should we come to that stage. It was important for the Polish authorities to be aware that the Bank, even when discussing discrete investment projects, would always seek to understand the context of each investment, the overall macro and sector policy framework affecting it and the other options for increasing the efficiency of the use of capital. Mr. Wapenhans concluded by stressing that the Bank sees its role in a wide context, with special added responsiblities should other financial sources wish to associate themselves with the Bank lending.

Attachment

JLoos/mct
(1705G)

Attachment

Polish Delegation

Mr. Zbigniew Karcz	Chairman of the Delegation, Director of the Foreign Department of Ministry of Finance
Mr. Stanislaw Pawlak	Director of the Treaty-Law Department, Ministry of Foreign Affairs
Mr. Grzegorz Wojtowicz	Director of the Foreign Department, National Bank of Poland
Mr. B. Samojlik	Economic Advisor

February 14, 1986
JLoos/mct
(1705G)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE : February 13, 1986 CONFIDENTIAL

TO : Files

FROM : Jane Loos, Acting Division Chief, EM1A

EXT. : 32469

SUBJECT: POLAND - Consultations with the Secretary's Department

1. A delegation from Poland is in Washington this week to participate in a meeting of the Membership Committee of the IMF (See attachment for list of delegation members). They took the opporunity of this visit also to hold discussions with the Bank. The first meeting took place on Wednesday, February 12 and was hosted by Mr. Thahane. Mrs. Clarke, Messrs. Rahkonnen and Crevier from the Secretary's Department and I attended. The delegation will also meet with Mr. Wapenhans and Mr. Lari on Friday, February 14.

2. The leader of the delegation (Mr. Karcz, Director of the Foreign Department of the Ministry of Finance) indicated that the Poles felt well prepared for the membership discussions at the IMF, and looked forward to closing this stage and proceeding with normal cooperation with both the IMF and the Bank, explaining that it was their wish to proceed with Bank membership on the same day that they are accepted by the IMF. He anticipated no specific problems for Bank membership on legal grounds. The member of the delegation from the Legal Department of the Ministry of Foreign Affairs then reviewed the legal documentation being prepared for Bank membership, which seemed to be well in hand. Mr. Karcz expressed pleasure that Poland had been categorized as a developing country in the IMF membership meetings, a designation which he also took to provide certain possibilities in the relationship with the Bank.

2. Mr. Karcz acknowledged that the Poles knew little about the Bank's "mechanismos" and how to utilize the possibilities available to them as members. His preliminary view was that they would like Bank assistance in three sectors -- agriculture, energy conservation, and export promotion. He explained that they had a lot of experience with project work in the late 1970's, which, despite the criticism, was not all bad. He took pains to explain that one of the major problems with these projects was that many of them were not finished, due to the breakdown of contacts with external commercial financiers in the early 1980's. The Poles intended to use that project knowledge and the larger organizations in Poland which had participated in this process to prepare projects that would fit into the general pattern of Bank lending.

3. Mr. Karcz introduced Mr. Wojtowicz, Director of the Foreign Department of the National Bank of Poland, who will be responsible for major relations with the Bank. He also asked for confirmation that the Bank would be sending an informal exploratory misssion soon after membership was agreed with the IMF to facilitate the process of learning more about the workings of the Bank and to provide answers to questions the Bank may have.

4. Mr. Thahane explained that the Secretary's Department was immediately concerned with the question of Polish membership and suggested that the meetings with EMENA Regional management later in the week would provide a better occasion to discuss the broader-reaching issues of development strategy and the possible role of the Bank. He indicated that at this juncture, the Polish authorities should be aware of a problem facing the Bank concerning procedures for accepting new members. The Bank's authorized share capital has been almost fully allocated, leaving only 140 unallocated shares available to new members; as the standard membership allocation is 250 shares, not counting the subscription shares which are related to the quota in the IMF, this means that exceptional arrangements may have to be made to accept additional members into the Bank at this time. He also indicated that the Bank was aware of the pace of processing membership in the IMF and asked for the understanding and assistance of the Polish authorities in coming to a mutually agreeable solution.

5. Three options have been formulated so far: (i) increase the Bank's capital by the amount required to complete Poland's subscription (this would require approval by 75T of the Bank's voting power as opposed to 51% normally required for membership; (ii) complete membership formalities for Poland, allocating a nominal number of shares to be supplemented by an additional subscription when the next general capital increase takes place; or (iii) holding all applications until the next general capital increase. There are a number of legal and political factors to be taken into account in deciding how to proceed, and Bank management and the Board of Executive Directors will need to take the decision shortly.

6. Mr. Karcz indicated that, of the sencond and third alternatives, he would prefer the second alternative, treating the matter of the shares as a technical issue not related to Polish membership, provided that they would still have access to the Bank's resources. He cautioned however that this was his first reading and that there were also political considerations to be taken into account from their side. Mr. Thahane explained that there has not been a direct link between the size of subscription and access to Bank resources, but suggested that we work through these matters on a step by step basis, staying in close contact as matters develop.

7. Mr. Karcz explained that they did not yet have an answer on the question of which constituency they would join, but they were operating under the assumption that the matter would be resolved before the next Annual Meeting. He indicated that once the matter is solved in the IMF, an answer would follow for the Bank.

Attachment

cc: Messrs. Wapenhans (EMNVP); Lari, Nouvel (o/r)(EM1); Thahane (SEC)

JLoos
1705G

ATTACHMENT

1. Mr. Zbigniew	KARCZ	Chairman of the Delegation, Director of the Foreign Department of Ministry of Finance
2. Stanisław	PAWLAK	Director of the Treaty-Law Department, Ministry of Foreign Affairs
3. Mr. Zdzisław	SADOWSKI	Chairman of the Polish Economists Association
4. Mr. Grzegorz	WOJTOWICZ	Director of the Foreign Department, National Bank of Poland
5. Mr. Leszek	ZIENKOWSKI	Advisor to the Central Statistical Office
6. Mr. Jan	BONIUK	Embassy of the Polish People's Republic in Washington, Financial Counselor

Washington, D.C.
January 22, 1986

CONFIDENTIAL

UPDATE ON IMF MEMBERSHIP AND QUOTA CALCULATIONS

1. The membership committee of the IMF concluded its consultations on February 13, 1986, after allowing the Polish authorities to present their own case directly.

2. The Poles accepted the IMF staff calculation of GDP and trade statistics (including the exchange rates used for CMEA trade). They directed their arguments toward supporting the IMF staff designation of Poland as a developing country and stressing the need to look at the the potential strength of the Polish economy, rather than at the one point in time (1980) used for the quota calculations. After taking these more "qualitative" factors into account, the Poles suggested a quota of SDR 840 million, compared to the staff recommendation of SDR 690-710.

3. The membership committee was not convinced that the "qualitative" factors suggested by the Poles had any bearing on their deliberations. The committee explicitly acknowleded that the setting of the quota was not a technical matter, but rather one of comparisons, and therefore spent a lot of time discussing what were the appropriate comparators. The US pressed strongly for a grouping of comparators which included such countries as Finland and Austria (with relatively low quotas), whereas others lobbied for a position in the range of non-oil developing countries.

4. The committee decided to recommend a quota of SDR 680. This decision will be communicated to the Poles before they leave, as it is the practice of the membership committee to inquire of the applicant if the recommended quota is acceptable.

5. The committee's decision will come as a blow to the Poles, who had been expecting at least what the IMF staff had recommended, and may possibly embarrass them with their authorities at home. And coming on top of the technical problems of getting shares for membership in the Bank, they are not likely to be in a good mood for the meeting with EMENA Regional Management.

February 13, 1986
JLoos
1705G

DRAFT

AGENDA FOR EMENA REGIONAL MEETING

WITH POLISH DELEGATION

February 14, 1986

11:00 AM

1. Welcome for first substantive discussion of potential cooperation.

2. Overview of Bank's current development role and outlook, and the changes since the Poles last participated.

3. Linkage of macroeconomic conditions, sectoral policies and investment strategies; the Bank does not just look at the margin of new investments, but also at the whole structure.

4. Next contacts -- exploratory mission to provide more information on the Bank to the Polish authorities and to lay the ground work for the proposed full economic mission which will be sent after membership in the Bank is formalized.

SENIOR MANAGEMENT BRIEF

1988 ANNUAL MEETINGS BRIEF

POLAND
August 30, 1988

Meeting with: Prof. Wladyslaw Baka, Secretary of Politburo, and Bank Governor

Population: 37.8m (1987)
GNP per capita: $1920 (1987)

Estimated Growth Rate: 0.8% (1980-85)

	($m)		($m)
Total Commitments to date:	none	FY88 Commitments:	none
Lending Program: FY89-90	$725		

Summary Data	Average 1983-87	1988
GDP growth	4.2	4.5
Convertible & Non-Conv. Currency		
Export growth	6.0	8.0
Import growth	6.4	8.0
Convertible Currency		
Export Growth	6.5	11.0
Import Growth	4.1	10.0
Current Account Deficit (% GDP)	-1.1	-0.7
Gross Debt Service Ratio (Paid)	27.0	35.0
(Owed)	99.4	65.0
Annual Inflation Rate	19.1	54.0

IMF Status as of 8/88:
Art. IV report 8/88;
Board Disc. 9/14/88

Background:

1. Political: internal-popular support for Gov. remains weak, constraining its capacity to pursue economic reforms which necessarily have short run, adverse consequences; recent party shakeup to elevate reformers; external - good support for reforms from USSR; warming trend in West.
2. Economic: recovery continues, with strong export growth, but further institutional/structural reforms needed to sustain growth; internal and external adjustment program being developed.
3. Bank Operations: active ESWP and advice on reform/recovery programs; two loans for key export activities ready to negotiate and solid pipeline of restructuring activities being prepared.

Issues likely to be raised by the Delegation

1. Progress on Government's Reform and Adjustment Plans
2. Scope and Timing of Bank lending
3. Constituency, if it remains unresolved

Issues to be raised by Bank Management:

1. Prospects for Implementing Economic and Political Reforms
2. Pace of Current Account Adjustment
3. Strategy for Dealing with Paris Club

Attachments:
FIVE-YEAR LENDING PROGRAM: FY89-93 (FY88 actual)
Biographical Information

2805G

Mr. F. Bleux
Deputy Secretary-General
World Confederation of Labour
33 rue de Treves
B-1040 Bruxelles
Belgium

March 14, 1985

Dear Mr. Bleux:

On behalf of Mr. Clausen, I acknowledge receipt of your letter of February 27, 1985, regarding Poland's application for membership in the World Bank.

As you probably know, membership in the Bank comes only after a country has secured membership in the IMF whose negotiations with Poland have not yet been completed. However, I have passed your letter to the regional department concerned for its information.

Sincerely yours,

Shahid Javed Burki
Director
International Relations Department

CB CBoucher/bj

cc: ~~Mr. Southworth,~~ EXC (with incoming)
cc: Mr. Lari, EMIDR

#25 logged out OK

FORM NO. 89
(2-83)

THE WORLD BANK

ROUTING SLIP	Date March 6, 1985

OFFICE OF THE PRESIDENT

Name	Room No.
Mr. Burki	E-812

	To Handle		Note and File
	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
	Information	XX	Recommendation

Remarks

Javed:

Your recommendation please.

Roy

From

WORLD CONFEDERATION OF LABOUR

HEADQUARTERS : 33, RUE DE TREVES - B-1040 BRUXELLES - BELGIUM
TEL. 02/230 62 95 - TELEGRAMS : MUNDOLABOR - BRUSSELS - TELEX : 26 966

251

Mr. A.W. CLAUSEN
President of the World Bank
1818 H Street
NW. WASHINGTON DC 20433
USA

DATE, February 27, 1985

OUR REF.: FB/jt 0286
YOUR REF.:

Dear Mister President,

Re : *Stand taken by the NSZZ SOLIDARNOSC as regards Poland's affiliation to the World Bank*

We beg to inform you of the stand taken by the NSZZ SOLIDARNOSC as regards Poland's affiliation to the World Bank.

The enclosed statement was drawn up by the Co-ordinating Office abroad of NSZZ SOLIDARNOSC in Brussels and is based upon a document from the SOLIDARNOSC governing body in Poland, signed by Zbigniew BUJAK on behalf of the TKK.

The World Confederation of Labour endorses this statement which is fully consonant with the WCL point of view that a country's affiliation to the World Bank is not to result in burdening the workers of that country to the full and exclusively with the measures to amortize its external debt.

Wishing you good receipt, we remain, Dear Mister President,

Yours faithfully,

pp. F. BLEUX
Deputy secretary-general

WORLD CONFEDERATION OF LABOUR

HEADQUARTERS : 33, RUE DE TREVES - B-1040 BRUXELLES - BELGIUM
TEL. 02/230 62 95 - TELEGRAMS : MUNDOLABOR - BRUSSELS - TELEX : 26 966

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Yours faithfully,

F. BLEUX
Deputy secretary-general

OFFICE OF THE PRESIDENT
1985 MAR -4 PM 6: 18
RECEIVED

BIURO KOORDYNACYJNE NSZZ «SOLIDARNOŚĆ» ZA GRANICA
COORDINATING OFFICE ABROAD OF NSZZ «SOLIDARNOŚĆ»
BUREAU DE COORDINATION À L'ETRANGER DE NSZZ «SOLIDARNOŚĆ»

9, avenue Joyeuse Entrée, 1040 Bruxelles, Belgique

NSZZ "Solidarnosc" summary position on the issue of Poland's membership to the International Monetary Fund.

1. The Polish government is anxious to join the IMF and the World Bank. In order that Poland's membership to these organizations truly benefit the Polish economy, it is important to request that a certain number of conditions be met.

2. We are well aware of the difficulty in expecting the IMF to set political conditions for Poland's entry to the IMF and World Bank. However, to achieve any kind of economic progress, political conditions, however minimal, are absolutely essential. We must mention them in the hope that they will be pressed for, at least informally. We believe that in order to ensure an atmosphere and mechanisms for peaceful conflict-resolution in enterprises - which is indispensable for any sustained increase in productivity - local trade union pluralism (i.e. the right of workers to establish and to join organizations of their own choosing) must be allowed. Furthermore, secrecy and censorship concerning economic matters (exluding those of the military), must be abolished. Without these conditions, no independent monitoring of policies is possible, including the implementation of any recommendations by the IMF and World Bank.

3. As for the issue of economic conditions, we should like to emphasize at the outset that NSZZ "Solidarnosc" will come out strongly against measures leading to the substantial reduction of consumption, increases in prices, freezes on real wages or deterioration in social care. This is not because of a trade union bias, but simply because we believe that the further deterioration of living standards would not only be harmful to economic recovery, but also increase the danger of an uncontrolled social explosion with all of the ensuing consequences. The road to an improvement in the Polish economic situation in general, and the ability to service the debts in particular, can only be carried out through a structural change in the economic mechanism.

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tlx 24464 sol bk b

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Bank : CGER
21, rue Archimède
1040 Brussels, Belgium
account :
GDKZ «SOLIDARNOŚĆ» 001-1129179-78

4. Should the IMF be unable to insist on the introduction of a particular type of economic mechanism, it can certainly point out and insist on removing the inconsistencies in the officially proclaimed economic mechanism prevalent in Poland today. The basic new rule of so-called "3 x S" (self-dependence, self-finance and self-management in the enterprise), is practically paralized by the planning centre's old structure. Old practices remain, such as continuous changes in regulations and financial parameters which violate the stability of rules, the concentration of the entire money-flow in a 'mono-bank' system instead of a plurality of banks and credit institutions controlled only in general by a central bank, etc. Such a situation excludes proper responsability for economic decisions. It is vital for the IMF and the World Bank to understand the complexity of the current economic mechanism in Poland in order to avoid seemingly obvious recommendations which would, in practice, lead to unexpected results. To hope to achieve market equilibrium by price increases under conditions of 'soft budget constraints' is senseless.

5. Special attention should be paid to direct measures which would stimulate export through a more realistic and flexible exchange rate policy. Investment policy should be evaluated from this point of view as well. In particular, projects financed by the IMF, the World Bank and related credits, must be evaluated first and foremost in terms of their convertible currency earnings capacity. One of the greatest dangers in Poland's current investment policy is an excessive concentration on projects that have already been initiated (seemingly requiring fewer additional outlays) because it may lead to the petrification of the obsolete and inefficient structure of production capacities which exacerbate existing bottlenecks, especially in export potentials. The open tenders method for investment projects; open to state, cooperative and private enterprises both domestic and foreign, should be applied as widely as possible.

6. A question of paramount importance, and one which can, in our opinion, be included among the conditions, is the full and genuine observance of equal rights in economic activity for all ownership sectors: private, municipal, cooperative and state. The possibility and security of foreign private investment should be statutorily guaranteed, with the right for the state to control the direction of such investments (e.g. through licensing or creation of joint ventures). We also believe that private economic activity (including the right to form partnerships, organize cooperatives, etc.) should be as open to the indigenous population as it now is for Polish expatriates.

We should like to point out that this brief summary which merely presents a general view on the issue of Poland's membership to the IMF and the World Bank, can be supplemented by more detailed materials, including independent expert opinions on particular matters. For instance, a number of texts written in 1981 and pertaining to the issue of the reform of economic mechanisms, are available and include a government blueprint which would, if implemented, indicate substantial progress over the present situation. Another such document is the NSZZ "Solidarnosc" draft proposal on socio-economic reform, prepared by the Network of "Solidarnosc" Organizations in Leading Factories (SIEC) - (see Solidarnosc Weekly, special issue, no. 29/59, 5 September 1981, published by the Regional Board of NSZZ "Solidarnosc" in Gdansk). Leszek Balcerowicz's works are also highly recommended.

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Prepared by the Coordinating Office Abroad of NSZZ "Solidarnosc", following the instructions of the Temporary Coordinating Commission of NSZZ "Solidarnosc" (TKK) - the executive leadership of NSZZ "Solidarnosc" in Poland.

Brussels, February 1st 1985.

CZEGO DOMAGAĆ SIĘ OD MFW.

Wydaje się, że rządowi PRL zależy w jakimś stopniu na przystąpieniu do MFW i Banku Światowego. "S" winna się domagać, by w zamian za przyjęcie i udzielanie kredytów, MFW zażądało spełnienia szeregu warunków politycznych i ekonomicznych. Minimalnym warunkiem politycznym jest wprowadzenie w Polsce pluralizmu związkowego. Co najmniej na poziomie każdego zakładu pracy załoga musi mieć prawo do oddolnego samodzielnego tworzenia i wstępowania do takich związków jakie sobie życzy. Istniejące zaś samorządy pracownicze muszą mieć możność działania zgodnie z ustawami o samorządzie i przedsiębiorstwie w ich pierwotnej wersji przyjętej przez Sejm w 1981 r.

MFW musi zrozumieć, że warunkiem spłacania przez PRL starych długów i nowych pożyczek jest pokój społeczny i gospodarczy. Niekontrolowany wybuch społecznego protestu, który stale Polsce grozi wpłynąłby katastrofalnie na funkcjonowanie gospodarki i mógłby doprowadzić do władzy w PRL siły terroru, mogące zerwać stosunki z Zachodem i jednostronnie odmówić spłat długów. Pluralistyczne związki i niezależne samorządy pracownicze są niezbędnymi instytucjami, które mogą stać się miejscem pokojowego i zgodnego z prawem rozwiązywania konfliktów, niedopuszczającymi do ich kumulowania się i przekształcania w niekontrolowany wybuch.

Zniesiona też musi być tajemnica państwowa i cenzura na cywilną informację gospodarczą. Dałoby to, łącznie z istnieniem niezależnych związków i samorządów pewne gwarancje, że realizacja zaleceń MFW będzie mogła być obserwowana przez krajowe niezależne struktury społeczne, które będą mogły dostarczać informacji o ich przebiegu.

Warunki polityczne tutaj tylko sygnalizujemy. Ich rozszerzenie pozostawiamy działaczom politycznym. Chodziło nam o pokazanie na konkretnym przykładzie, że muszą one być koniecznie uzasadnione ekonomicznie, i to z punktu widzenia ekonomicznych interesów MFW. Ponieważ niektórzy eksperci uważają, że w ogóle nie ma co liczyć na polityczne warunki ze strony MFW, sformułowaliśmy tylko warunki minimalne, o które mimo wszystko trzeba zabiegać. Choć bowiem MFW trudno je będzie stawiać, mogą to jednak zrobić, choćby nieformalnie, te kraje /głównie USA/ które będąc członkami MFW blokują wejście doń PRL.

Szerzej zajmujemy się warunkami ekonomicznymi. Przede wszystkim trzeba jasno postawić sprawę, że "S" będzie zdecydowanie protestować jeśli MFW będzie wysuwać zalecenia /a rząd PRL będzie się na nie powoływał/ prowadzące do wyraźnego obniżenia konsumpcji społeczeństwa, wzrostu cen, zamrożenia wzrostu płac realnych czy obniżenia poziomu opieki społecznej. Nie tylko dlatego, że "S" jako związek zawodowy musi bronić poziomu życia robotników i całego społeczeństwa, ale także dlatego, że dalsze obniżanie tego poziomu zagraża utrzymaniu wydajności pracy oraz wzmaga napięcia społeczne i przybliża niebezpieczeństwo wybuchu niekontrolowanego protestu społecznego, grożącego negatywnymi skutkami również dla MFW gdyż zagrażałoby to perspektywom solidnego spłacania przez PRL starych i nowych /również zaciąganych w MFW/ pożyczek.

Zdolność płatnicza PRL naszym zdaniem powinna się poprawiać nie przez "zaciskanie pasa" ludności lecz przez kryjące w sobie ogromne rezerwy odejście od nieefektywnego systemu scentralizowanej gospodarki na rzecz jej głębokiej reformy.

MFW nie bardzo może ingerować w wybór mechanizmu funkcjonowania gospodarki /np. Rumunia, członek MFW utrzymuje nadal tradycyjny mechanizm nakazowo-rozdzielczy/, ale może zwrócić uwagę na niespójność już wybranego mechanizmu gospodarczego. Taka niespójność występuje w PRL, gdzie część gospodarki jest reformowana, część nie. Zniesienie niespójności polegałoby na wprowadzeniu całościowej koncepcji reformy w gospodarce. Trudno jest tutaj wymieniać wszystkie postulaty reformy. MFW musi się zapoznać z jej projektami które powstały w 1981 r., a zwłaszcza z projektem Sieci Wiodących zakładów /który załączamy/ i projektami zespołu SGPiS pod kierunkiem dr. L. Balcerowicza, i innymi projektami społecznymi. Między nimi występują pewne różnice /na ogół w szczegółach/. Podkreślić trzeba, że gdyby w PRL zrealizowano chociaż projekt rządowy z 1981 r., to już można by to uznać za znaczny postęp w stosunku do stanu dzisiejszego.

Do koncepcji reform z 1981 r. należy dodać to, co w nich nie występuje, a ma ogromną wagę dla uzdrowienia gospodarki. MFW powinien mianowicie, jako warunek stawiać zagwarantowanie przepisami ustaw równorzędnego traktowania i równości wobec prawa wszystkich typów własności środków produkcji w gospodarce: prywatnej, samorządowej, spółdzielczej i państwowej. Ustawowo zagwarantowana powinna być możliwość i bezpieczeństwo inwestowania przez zagraniczny kapitał prywatny. Państwo określałoby jednak kierunki tych inwestycji /tak jak w Jugosławi w latach 60-tych/. Wymagałoby to prawa do tworzenia spółek akcyjnych o kapitale mieszanym, oraz stworzenia systemu zachęt do inwestowania dla prywatnego kapitału i zagwarantowania trwałości warunków działania spółek, zwłaszcza określonego prawa do przepływu części zysków za granicę.

Umożliwiona powinna też być działalność gospodarcza ludności, finansowana z jej prywatnych środków lub udzielanych im kredytów na cele produkcyjne, z prawem do zakładania prywatnych firm i spółek /a także spółdzielni/. Dotychczas bowiem z niewiadomych powodów przedsiębiorstwo może założyć w Polsce tylko obywatel obcy /choć polskiego pochodzenia/ mieszkający za granicą.

Konieczna jest też przebudowa systemu bankowego. Rozbiciu musi ulec monopol bankowy państwa /tzw. monobank/ na rzecz utworzenia samodzielnych i samofinansujących się, konkurujących ze sobą banków komercyjnych. Obok banków państwowych musi być miejsce na banki prywatne i spółdzielcze, musi być też możność tworzenia specjalnych funduszów, fundacji, różnorodnych towarzystw ubezpieczeniowych itp.

Szczegółowe koncepcje reformy zawiera projekt "Sieci" który załączamy.

Zwracamy uwagę na to, że zalecenia dotyczące zmian funkcjonowania gospodarki mogą dać pozytywne rezultaty tylko wtedy, gdy będą kompleksowe. Zalecenia odcinkowe, bez zmian całości gospodarki, mogą przynieść skutek odwrotny od oczekiwanego. Np. standartowe zalecenie zniesienia kontroli cen przez państwo bez rozbicia monopolistycznej pozycji przedsiębiorstw, bez reformy banków i reformy szeregu innych elementów - prowadziły jedynie do wzrostu cen bez poprawy efektywności gospodarowania. Takie przykłady można mnożyć.

Najistotniejsze są jednak warunki jakie MFW będzie chciał i musiał stawiać już nie w momencie przyjmowania PRL, lecz w momencie udzielania kredytu. Będzie musiał ściśle określić na jakie cele kredyt przekazać. Tu więc mamy największą możliwość i obowiązek wywierania nacisku na MFW.

Przede wszystkim musimy przestrzec przed udzielaniem kredytów na kontynuowanie programu inwestycyjnego z lat 70-tych. Kontynuowanie przeważającej większości tych inwestycji prowadziłoby do utrwalenia wadliwej struktury gospodarki, do pogłębienia nierównowagi gospodarczej i zmniejszenia zdolności płatniczej PRL. Jest to bowiem program budowy kosztownych i nierentownych obiektów, które pochłaniałyby nadmierne ilości surowców, materiałów i energii, wymagałyby ogromnego importu, byłyby niezdolne do zaspokojenia potrzeb rynku wewnętrznego i potrzeb eksportu. Prowadziłoby to jedynie do kolejnego załamania, tyle że na nowym, wyższym poziomie zadłużenia.

Nowe kredyty nie mogą być znowu zmarnowane, a ich spłata nie może znowu obciążać głównie konsumpcję społeczeństwa. MFW musi więc mieć możliwość obiektywnej kontroli ich wykorzystania. Musi móc porównać nakłady z wynikami w dziedzinie do której kredyty napłyną. Musi móc porównać efektywność poszczególnych propozycji wykorzystania kredytu. Takie porównania i oceny są niemożliwe w oparciu o fikcyjne, nieobiektywne krajowe ceny. Warunki te może spełnić tylko taka dziedzina produkcji, której opłacalność można obliczyć w cenach światowych, a więc ta, której towary przechodzą przez rynek zachodni. A więc warunki te może spełnić tylko skierowanie kredytów MFW w inwestowanie w produkcję eksportową przeznaczoną na Zachód. Tylko wówczas będzie można porównać nakłady w dolarach /w postaci zakupu dóbr inwestycyjnych na Zachodzie z kredytu MFW/ z wynikami w dolarach uzyskanych ze sprzedanej na Zachodzie produkcji. Tylko wówczas będzie można zastosować klasyczne metody wyboru wariantów inwestowania oparte o ceny handlu zagranicznego, wyboru dokonanego w drodze obiektywnego konkursu projektów pod kontrolą MFW. Konkurs winien być otwarty dla wszystkich projektów, niezależnie od tego czy realizować je chce firma państwowa, spółdzielcza czy prywatna. Kredyt wewnątrz kraju winien być przydzielany przez bank centralny na te projekty, które rokują największe zyski dewizowe, a firmy muszą kredyt spłacić dewizami ponosząc przy tym pełne ryzyko i odpowiedzialność ekonomiczną.

Gwarantowałoby to krajowi uzyskanie dewiz które możnaby przeznaczyć na spłaty kredytu i na uzupełnienie importu zaopatrzeniowego do rynkowej produkcji. Oczywiście kredyty te powinny być wykorzystane w eksportowym przemyśle przetwórczym, a nie surowcowym, by nie utrwalać surowcowego charakteru naszego eksportu.

*

Domagać się by MFW stawiał warunki należy. Nie można jednak mieć zbytnich nadziei na skuteczność tego domagania się. Nie wiadomo na ile MFW będzie liczyć się z "S" i czy rząd PRL tak bardzo pragnie wejścia do MFW by ulec naciskom. Nie ma żadnej pewności że polityczne warunki, choćby nieformalnie będą postawione a zwłaszcza że będą uwzględnione. A także, że zalecenia reformy gospodarczej będą przez PRL wysłuchane. Istnieje natomiast duże prawdopodobieństwo, że MFW wyda zalecenia obniżające poziom życia ludności i "S" zapewne będzie zmuszona niejeden raz do protestów. Polityka MFW już w niejednym kraju doprowadziła do groźnych pozruchów społecznych. Dlatego "S" nie powinna w żaden sposób ustawiać się w roli gwaranta dla polityki MFW. Nie powinna jednoznacznie wypowiadać się za wejściem do MFW tak, aby potem czuć się wobec zaleceń MFW zobowiązana.

Jedynie zalecenie by kredyty szły w inwestycje dające eksport na Zachód i były rozdzielane nie biurokratycznie lecz w drodze otwartego konkursu projektów - może leżeć w interesie zarówno MFW, rządu PRL i społeczeństwa.

Trudno jednak wyobrazić sobie by "S" mogła powiedzieć, że nie chce wejścia PRL do MFW. Wałęsa już powiedział, że tego chcemy. Mimo wszystko, przynajmniej na dłuższą metę wydaje się, że zawsze lepiej jest wiązać się z Zachodem niż grzęznąć w ramach RWPG.

listopad 1984.

Z upoważnienia Tymczasowej Komisji Koordynacyjnej
Zbigniew Bujak