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The Scope of Poland's Economic Dilemma

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The Scope of Poland's Economic Dilemma

Central Intelligence Agency
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Key Judgments

Poland's leadership is confronted with growing consumer unrest over chronic shortages of meat and quality consumer goods and with balance-of-payments stringencies that have created conflicting, perhaps irreconcilable, demands. In an effort to deal with these problems, the current five-year development plan has been revised to increase the availability of consumer goods and services and to reduce capital goods imports. The shift will reduce economic and industrial growth and, over the next year or two, probably cut the growth of imports from the West. Although such actions will not solve either problem, it is probably the most Poland can do in the short term, given its severe political and economic constraints.

Poland's difficulties stem from economic policies initiated in 1970 which simultaneously pushed rapid industrialization and sharply rising living standards. To help achieve these goals, Poland imported massive amounts of Western technology and equipment with attractive credits made available by eager Western exporters. To boost consumption, the regime permitted incomes to grow rapidly, increased the supply of housing and quality consumer goods, and kept retail prices stable.

By 1974, these policies began to founder:

- The growth of exports to the West could not keep pace with sharply rising import growth and mounting hard currency debts.
- Despite a declining growth of exports, imports were maintained at peak rates.
- Worker income continued to grow rapidly while the availability of consumer goods increased slowly.
- To avoid worker dissatisfaction, prices were kept at 1967 levels while costs rose and food subsidies soared.

- Several years of bad weather pushed up agricultural imports and cut the growth of consumption, particularly of meat.

Despite the growing economic difficulties, the regime continued to pursue policies designed to boost meat consumption—the symbol of improvement in living standards for the Poles. The regime instituted long-range policies to strengthen the private farm sector—the source of 80 percent of Poland's agricultural output—to encourage increased livestock production. Grain imports were boosted sharply to increase the domestic fodder base. Nevertheless, meat output fell and growth of per capita meat consumption has leveled off, despite sharp cuts in exports in 1976 and increased imports in order to bolster domestic meat supplies. Meanwhile, these trade measures have contributed substantially to the trade deficits with the West, now running about $2.5 billion a year, and to a hard currency debt which by the end of 1977 totaled $12.8 billion.

The outlook over the next few years is for increasing economic constraints. Exports to the West are growing at a substantially lower rate as they encounter trade barriers, Western economic sluggishness, and competition in Western markets. Meanwhile, the revised development plan and continued hard currency deficits which have forced cuts in imports from the West will impinge on long-run economic growth. If Poland is to maintain a level of imports sufficient to prevent any further cutbacks in planned growth, it must either receive substantial assistance or arrange a large-scale debt rescheduling. To be effective, aid must come soon. Further cutbacks in growth will reduce growth in real wages and other worker benefits. The result is likely to be more worker unrest.

The Scope of Poland's Economic Dilemma

Introduction

Poland's leadership currently is confronted with growing consumer unrest over chronic shortages of meat and quality consumer goods and with balance-of-payments stringencies that impinge on economic growth. These problems stem largely from (a) accumulating hard currency debts that are placing constraints on imports, (b) bad weather, which contributed to stagnating agricultural output, (c) economic recession and slow recovery in the West, which has reduced the growth of Polish exports, and (d) critical errors in economic policy (made largely out of domestic political considerations) to deal with these problems.

The burgeoning balance-of-payments problems which have sharply boosted Poland's hard currency debt result in large part from an inability to rapidly increase exports to the West while imports remain high. Imports have not only risen faster than Poland's export capability but its traditional exports also have encountered trade barriers and reduced demand in Western markets. Moreover, new export-oriented industries developed with large hard currency borrowings have run into marketing problems because of quality shortfalls and obsolescence.

So far, the Gierek regime has failed to deal effectively with its problems. It has made some cuts in capital goods imports, but has made only a modest retreat from its high-growth policies. At the same time, fearing adverse consumer reactions, Warsaw continues to freeze retail prices of basic foods and has failed to contain wage growth, thus exacerbating chronic consumer goods shortages.

Impact of Poland's Development Strategy

Since coming to power in 1970, the Gierek regime adopted development policies that have placed emphasis on modernizing Poland's economy and boosting living standards. Gierek believed that a "new" approach was imperative—Poland's economic growth was steadily falling behind that of the less developed East European countries which had begun modernization programs in the 1960s.

To help achieve modernization, Poland imported massive amounts of Western technology and equipment with attractive credits made available by eager Western exporters. Although the Poles expected these credits to sharply increase their hard currency debt, they believed repayment could be made with expanded exports to the West of goods produced in the newly constructed plants. To raise living standards and labor productivity, the regime boosted incomes and supplies of housing and quality consumer goods and kept food prices stable—especially for meat.

Poland's development strategy was highly successful in 1971-73 as real GNP grew 7.3 percent annually. The rapid rise in real incomes enabled consumer spending to surge. Large trade deficits caused the hard currency debt to grow, but it was manageable. By 1974, however, the economic picture began to darken. Constraints were developing as the trade deficits jumped and the hard currency debt rose sharply. Adding to the difficulties were problems beyond Warsaw's control, particularly unfavorable weather, which contributed to stagnating agricultural output in 1974-77 and the Western recession and subsequent sluggish recovery, which reduced the growth of Polish exports.

The regime, moreover, compounded its trade problems with critical policy errors. With the onset of the Western recession, most East European countries cut back on plans for imports from the West, and, in some cases, on economic growth plans. But the Poles, driven by the desire for rapid industrialization and the belief that domestic political stability was linked to further improvement in living standards, continued to push their ambitious development program. As a result Polish imports of Western industrial goods continued to increase.

Meanwhile, the regime permitted consumer incomes to grow rapidly, primarily by not bringing under control unplanned increases in workers' bonuses. The 11-percent average annual growth in aggregate real incomes in 1971-76 far outstripped available supplies of consumer goods and services. This inability to satisfy rising consumer demands, especially for meat, generated considerable consumer unrest, necessitating grain and meat imports to at least maintain the level of meat consumption.

Meat—the Persistent Problem

Meat consumption is a critical element in Polish economic policy. Not only does it impact heavily on the trade deficit but its growth has significance for domestic tranquility.[1] It was one of the chief issues that brought Gierek to power. In December 1970 Gierek's predecessor, Wladyslaw Gomulka, boosted meat (and other food) prices sharply to stem rapidly rising demand. Polish workers, already chafing over government efforts to clamp down on wage growth, found the increase too much to accept, particularly during the Christmas season, when meat purchases are increased. They reacted violently.

Gierek's Initial Success

Gierek moved quickly to calm the populace by importing meat and raising wages for the lowest paid workers. In March 1971 he rescinded the food price hikes and froze them at 1967 levels (the last time prices had been raised significantly). In order to provide incentives for private farmers (who account for almost 80 percent of Poland's agricultural output) to boost production, the government abolished compulsory grain deliveries to the state, raised purchase prices for grain and livestock, and increased grain imports. Private farmers also were given legal title to their land and were brought under the national health service.

Gierek's policy met with early success. Four consecutive record grain crops in 1971-74 and a sharp increase in grain imports significantly expanded the fodder base (see table 1 and figure 1). Meanwhile, government purchase prices for cattle and hogs were set well above the cost of feedstuffs (see table 2). This improved profitability of private farming contributed significantly to a 27-percent jump in livestock production and a 25-percent rise in per capita meat consumption (see table 3). Moreover, enough meat was produced to also permit a large boost in exports.

[1] The Poles' sensitivity to the supply of meat reflects their rapidly rising incomes and the lack of alternative consumer goods on which to spend that income. The only effective outlet for the consumer is to improve the quality of the diet. Thus, much of the Poles' spending centers on meat and meat products, especially pork. The low relative prices of meat intensifies the problem by shifting an even larger share of spending to these products. Government pricing policy and the consumer attitude toward increased meat consumption, which is equated with social status, lead to chronic excess demand and consumer unrest

Table 1

Poland: Production of Selected Crops

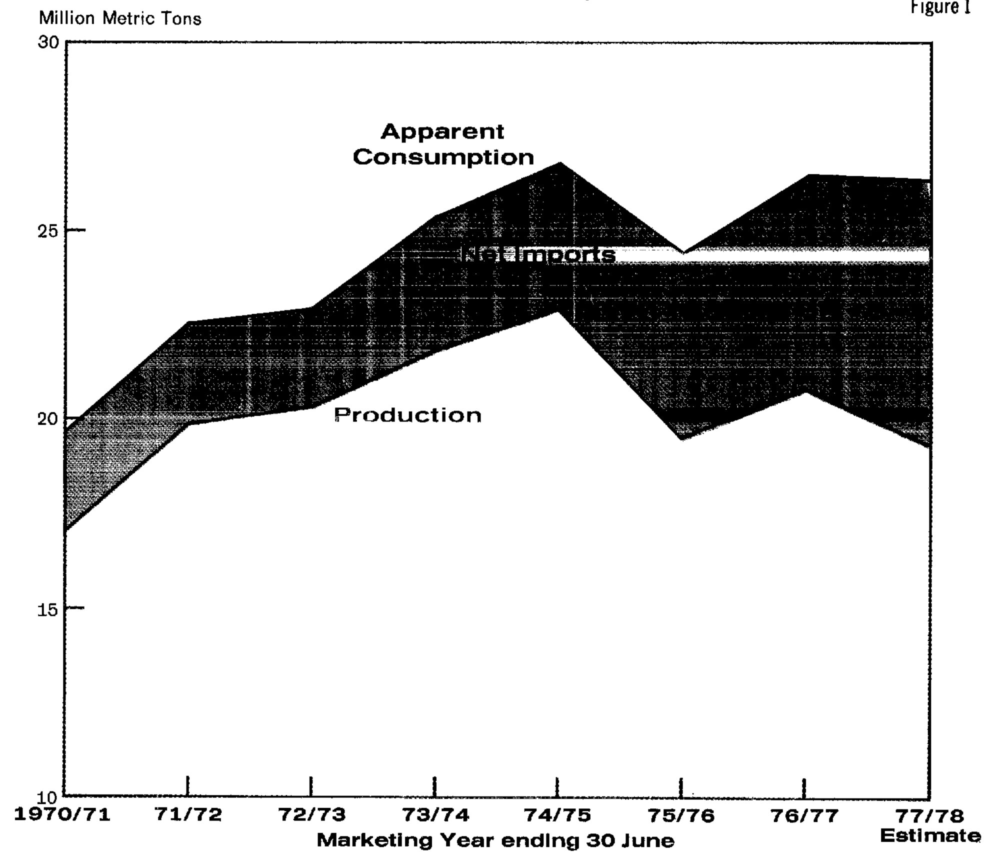
Million Metric Tons

	1970	1971	1972	1973	1974	1975	1976	1977[1]
Grain	16.3	19.9	20.4	21.9	23.0	19.6	20.8	19.4
Of which:								
Wheat	4.6	5.5	5.1	5.8	6.4	5.2	5.7	5.4
Rye	5.4	7.8	8.1	8.3	7.9	6.3	6.9	6.2
Barley	2.1	2.4	2.8	3.2	3.9	3.6	3.6	3.4
Potatoes	50.3	39.8	48.7	51.9	48.5	46.4	50.0	41.3
Sugar beets	12.7	12.6	14.3	13.7	13.0	15.7	15.1	15.9
Fodder (root) crops	8.2	6.8	8.0	8.5	8.0	7.8	8.4	8.4
Vegetables	4.2	3.5	3.6	4.0	3.5	4.1	3.8	4.3

[1]Preliminary.

Poland: Grain Production, Consumption, and Trade[1]

Figure 1



1. Grains include wheat, rye, barley, oats, mixed grains, corn and sorghum.

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Table 2

Poland: Government Purchase Prices for Livestock and Cost of Feed to Farmers

Index 1970=100

	1971	1972	1973	1974	1975	1976	1977
Cattle prices	109	143	154	178	183	202	234
Hog prices							
Slaughter	126	134	134	135	141	165	198
Bacon	114	122	123	124	130	151	179
Feed concentrates	96	100	103	108	123	172	NA[1]

[1] Not available.

The Policy Falters

In 1975 the livestock expansion policy began to falter under the weight of rapidly rising costs, falling profits, and bad weather which reduced grain and fodder crops. A shortfall in the 1974 fall potato crop—a major source of feed for hogs—and other fodder crops forced many private farmers to purchase a larger than usual amount of livestock feed from the state. Moreover, farmers were reluctant to sell grain to the state, preferring to keep it for their own use. Both

Table 3

Poland: Per Capita Consumption of Selected Foodstuffs

Kilograms

	1971	1972	1973	1974	1975	1976
Meat	56.1	59.3	62.1	65.6	70.3	70.0
Of which:						
Pork	32.8	37.3	38.8	39.4	40.9	34.8
Beef	12.5	10.8	11.5	13.1	15.5	18.8
Potatoes	189.0	187.0	183.0	177.0	173.0	171.0
Sugar	39.6	40.9	42.0	43.9	43.2	43.9
Vegetables	85.8	83.8	93.0	84.3	94.0	88.2
Fruits	20.3	18.7	20.3	19.4	21.4	28.5

Table 4

Poland: Inventory of Livestock Herds and Production of Selected Livestock Products

	1971	1972	1973	1974	1975	1976	1977 [1]
	Million Head						
Livestock							
Hogs [2]	15.2	17.3	19.8	21.5	21.3	18.8	20.1
State farms	1.9	2.3	2.8	3.5	4.3	4.7	5.1
Private farms	13.3	15.0	17.0	18.0	17.0	14.1	15.0
Cattle [2]	11.1	11.5	12.2	13.0	13.3	12.9	13.0
State farms	2.0	2.2	2.4	2.7	2.9	3.1	3.3
Private farms	9.1	9.3	9.8	10.3	10.4	9.8	9.7
Poultry	88.9	92.9	94.2	96.6	99.8	79.2	NA [3]
	Thousand Metric Tons						
Livestock products							
Meat [4]	2,215	2,485	2,735	3,072	3,067	2,904	2,800
Of which:							
Beef	456	439	478	636	695	749	NA
Pork	1,313	1,590	1,771	1,888	1,793	1,537	NA
Milk	15,148	15,766	16,245	16,668	16,377	16,521	17,100
Butter	128	162	181	198	193	217	244

[1] Preliminary.
[2] As of 30 June.
[3] Not available.
[4] Carcass weight.

factors pushed up Polish grain imports in a tight world grain market. The higher cost of these imports was passed on to the farmer, but the regime failed to compensate the farmer with higher purchase prices for his livestock.

The resultant profit squeeze forced many farmers out of hog raising. By mid-1975, hog numbers on private farms had fallen 6 percent from their 1974 peak (see table 4). This trend was further exacerbated in 1975 by drought-induced shortfalls in grain and potato production. Even with massive imports, feed supplies remained expensive. By mid-1976, hog numbers on private farms had declined an additional 17 percent. More important, sow numbers dropped almost 20 percent, hampering future efforts to rebuild herds.

As livestock population declined, meat shortages emerged in late 1975. The government was forced to resort to what it hoped would be stopgap measures to boost domestic supplies; meat exports were sharply curtailed and imports were increased. Nevertheless, store queues lengthened and consumer tensions worsened.

Critical Errors in Pricing Policy

The meat problem would have been less severe if the regime had let meat prices, frozen at unrealistically low levels since 1967, rise gradually over the years. But the regime procrastinated for fear of adverse consumer reaction. By early 1976, however, the Polish leadership realized that domestic meat supplies could not be increased significantly in a short time and decided to curb demand for meat and other quality foods by raising retail prices. Moreover, the continuing price freeze in the face of steadily rising costs had sent government subsidies soaring. In 1975, food subsidies consumed 14 percent of the national budget compared with 6 percent in 1970. [2]

Gierek's advisers decided that any price increase would have to be substantial to have much effect on meat consumption, because Polish demand for meat is highly price inelastic. [3] In a major miscalculation, the regime decided on a steep, one-shot price boost. On 24 June, Prime Minister Jaroszewicz announced that meat prices would go up 69 percent; total food prices, 40 percent; and the cost of living, 15 percent. The government hoped to ease the impact by raising wages of low-income workers by 20 percent and those of middle- and high-income groups by at least 10 percent. It also expected to stimulate meat deliveries to the market by increasing purchase prices for livestock by about 20 percent.

Although expecting higher prices, the populace was stunned by the magnitude of the increases. Worker reaction was swift and often violent. Fearing a nationwide strike, the regime withdrew the increases the next day "for further consideration."

Despite subsequent efforts to mollify consumers, unrest remained high during 1976. The Poles, anticipating price hikes later in the year, began hoarding many consumer items, only intensifying existing shortages. The situation became so serious that the regime was forced to introduce sugar rationing in August. De facto rationing of meat, coal, and other commodities occurred in many localities through limits on purchases imposed by store personnel and local officials.

The government eventually announced postponement of a decision on food prices for at least a year, until Poland's economic problems could be studied. Meanwhile, to bolster domestic meat supplies, the government, acceding to the yearlong pressure to reduce meat exports, cut exports by 60 percent in the second half of 1976 and imported 42,000 metric tons of meat. Some 100,000 tons of meat reportedly were imported in 1977. These measures, however, merely enabled per capita consumption of meat to remain at the 1975 level.

Although a good harvest in 1976 enabled the regime to begin rebuilding herds and grain stocks, poor weather in 1977 again cut grain and fodder output. We estimate the harvest at about 19.4 million tons—some 7 percent below the 1976 level and about 16 percent below the record 1974 crop. In addition, the potato crop was 17 percent below 1976. In order to maintain its livestock expansion program, the regime was forced to continue its costly imports; otherwise it would have to initiate distress slaughtering.

The disastrous 1977 harvest so far has had little impact on livestock production. In contrast to 1975, when policy blunders aggravated the situation, the government intervened effectively. The regime raised purchase prices and introduced other measures that established a favorable price-cost structure, encouraging farmers to carry over livestock inventories through the winter. In addition, Warsaw publicized its planned large expenditures on grain imports to assure private farmers of adequate feed supplies. Consequently, hog numbers at the end of 1977 were 23 percent higher than at yearend 1976. Perhaps even more significant, the number of sows on private farms increased 16 percent.

[2] By the end of 1977 the share had risen to more than 15 percent.
[3] Polish studies indicate the demand for meat is highly income elastic—ranging from 0.6 to more than 1—with the highest elasticity in the lowest income brackets. Given the lack of adequate substitutes, a high income elasticity would indicate a highly price inelastic demand for meat at prevailing, low state-set prices.

Despite the increase in hog numbers, reduced meat exports, and substantial meat imports, meat supplies in 1977 still were lower than in 1976 because the larger numbers of livestock were not yet ready for slaughter. Hogs require a leadtime of 12 to 18 months before they are ready for the market. As a result, consumer unrest over meat shortages remained high throughout the year. Occasional scuffles requiring police intervention broke out at state-controlled meat stores, where consumers had to stand in line for many hours. Silesian miners, the elite of Polish workers, also staged strikes to protest the shortages. Reports of flood-induced crop losses also generated panic buying of flour, rice, and groats.

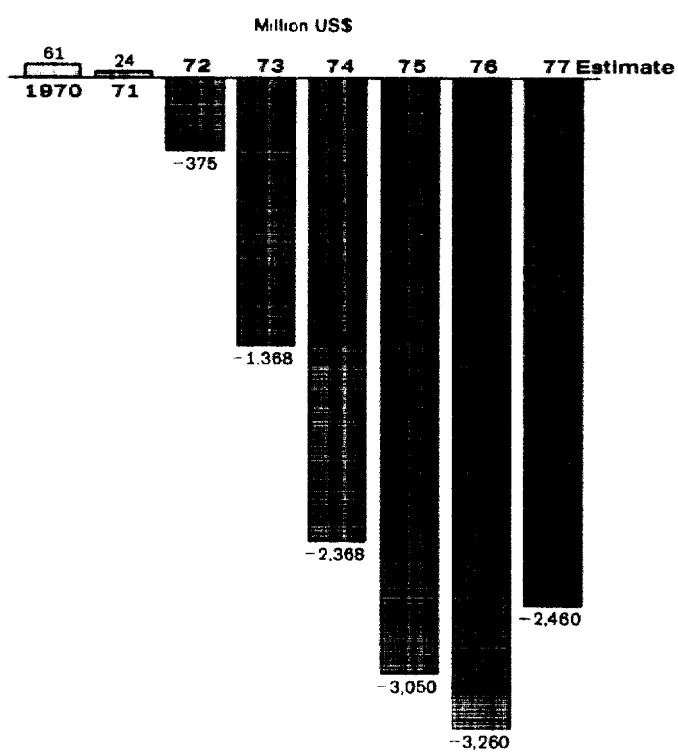
The Growing Trade Gap

Poland's meat policies have contributed significantly to the country's trade deficits with the West, which have burgeoned since 1972 (see figure 2). Imports surged, reaching $6.6 billion in 1976—more than seven times the 1970 level. A substantial part of the rise represented machinery and equipment, which totaled more than $9 billion in 1971-76. The increase in imports of high-priced Western grains and feedstuffs also contributed to the sharp rise, particularly in the latter part of the period. In 1976, imports of agricultural products and foodstuffs totaled $1.3 billion, more than six times the 1970 level. Sharp price rises in 1973-74 for imported oil, chemicals, steel, cotton, grain, and soybean meal also contributed to the deficit. In 1971-76, import prices rose nearly 60 percent. Although export prices rose faster, the impact was offset by a faster rise in the volume of imports than of exports.

While imports from the West grew almost 40 percent annually in 1971-76, exports rose only 23

Poland: Trade Balance With the Developed West

Figure 2



percent a year. About 40 percent of the total rise in export value represented higher export prices. Real exports actually declined in 1974-75 as the economic recession in the West took its toll. By 1976 Poland's trade deficit with the West totaled $3.3 billion—with imports twice the level of exports—in spite of some recovery in exports and attempts to curb import growth. Exports also were affected by the cut in meat exports to counteract consumer unrest, an import ban imposed in 1974 on beef and cattle by the European Community, and the United Kingdom's entry into the EC (which cut Poland's bacon exports by one-half).

Efforts to bring the hard currency trade deficit under control in 1977 by boosting exports were thwarted by sluggish Western economic recovery and soft world prices for Poland's major exports. Warsaw, however, succeeded in reducing imports. Imports of machinery and equipment and of some industrial materials were cut substantially and some hard currency raw material purchases were shifted to the USSR. As a result, Poland cut its trade deficit with the West by an estimated $800 million.

Financing the Deficit

To cover the trade deficits, Warsaw has had to borrow heavily from foreign official and private sources. Invisibles have contributed little. By 1975, mushrooming interest payments more than offset net earnings from services and transfer payments. By the end of 1977 Poland's net debt to the West totaled about $12.8 billion, compared with $800 million in 1970 (see table 5). Poland's major Western creditors are the United Kingdom, West Germany, and France, each of which holds roughly 20 percent of Poland's hard currency debt. The United States accounts for only 4 percent of the debt. [4]

Poland's early borrowing was largely in the form of government and government-backed credits. In recent years, however, Poland has become heavily dependent on private credit from Western commercial banks (see table 6). The borrowings soared in large part because of Warsaw's need to cover immediate financial needs arising from its large trade deficits and growing debt service payments. By yearend 1977, almost 60 percent of Poland's net debt consisted of such borrowings. As a result of the sharp rise and the rapid change of the structure of the debt, the share of merchandise exports required to service

[4] Excluding Polish liabilities to foreign branches of US banks.

Table 5

Poland: Estimated Hard Currency Balance of Payments

	1970	1971	1972	1973	1974	1975	1976	1977 [1]
	Million US $							
Merchandise exports, f.o.b. [2]	962	1,099	1,397	2,063	2,865	3,026	3,373	3,660
Merchandise imports, f.o.b. [2]	901	1,075	1,772	3,431	5,233	6,076	6,636	6,120
Services, net	Negl	Negl	5	−10	−5	−15	−25	−25
Interest income	−40	−40	−45	−80	−240	−400	−640	−860
Transfer payments, net	110	140	220	300	320	375	560	570
Current account balance	131	124	−195	−1,158	−2,293	−3,090	−3,368	−2,775
Financed by medium- and long-term credits, net [3]	−10	30	250	700	1,400	2,000	2,200	2,000
Errors and omissions [4]	−121	−154	−55	458	893	1,090	1,168	775
Outstanding net debt	770	800	1,100	1,900	3,950	6,930	10,200	12,800
	Percent							
Debt service ratios [5]	20	19	20	21	27	43	49	60

[1] Preliminary.
[2] Trade with the developed West.
[3] For the purposes of this paper, medium- and long-term credits are those with repayment periods of more than one year.
[4] Including short-term borrowing as well as some credits of up to five years. Also included are hard currency trade balances with the less developed countries and changes in foreign exchange reserves.
[5] Repayments of principal on medium- and long-term debt and interest on all debt as a percentage of merchandise exports to the developed West.

Table 6

Poland: Estimated Structure of the Net Hard Currency Debt [1]

Million US $

	1970	1975	1976	1977
Total	**770**	**6,930**	**10,200**	**12,800**
Western government-backed	320	2,130	2,600	3,200
Western government [2]	370	506	760	1,000
Private credits from Western commercial banks	80	4,010	5,800	7,400
Other		284	1,040	1,200

[1] End of year.

[2] Including amounts outstanding on US Export-Import Bank, Commodity Credit Corporation, and PL-480 credits and on a West German official financial credit.

the debt jumped from an estimated 27 percent in 1974 to 60 percent in 1975. [5]

Despite the reduction in Poland's trade deficit last year, rising debt service obligations required Poland to borrow more than $4 billion for the second year in a row. Warsaw drew about $1.5 billion in government and government-backed credits. Poland was able to raise the balance from commercial banks, but probably had to pay stiffer front-end fees.

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[redacted]

[5] The 1977 ratio drops to 45 percent if gross earnings from invisibles are added. But of invisibles earnings of roughly $1.2 billion (excluding interest), less than one-half was available to finance merchandise imports; the remainder covered expenditures on services.

[redacted]

Assistance From Moscow

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In 1976, Poland appealed to Moscow for assistance to ease its hard currency trade and financing difficulties. Moscow responded with a substantial aid package, including a 1-billion-ruble loan, above-plan shipments of raw materials, consumer goods, and a resumption of grain deliveries—suspended in 1975-76 as a result of the disastrous 1975 Soviet grain harvest. The Soviets agreed to boost annual crude oil shipments from 11 million tons to 13 million tons in 1977-80 and may have agreed to increase deliveries of raw materials, such as iron ore, that Poland buys from the West for hard currency. Moreover, the Soviets reportedly will pay for Polish equipment for joint projects of the Council for Mutual Economic Assistance in the Soviet Union on delivery. Previous payments have been made only after a venture was in operation.

There are no indications of any new assistance from Moscow since its loan and other promises of help given in 1976. Clearly, any program of economic assistance large enough to defuse the Polish situation would imply painful sacrifices for the Soviet economy and would be difficult for the Soviet leadership to undertake unless there were clear threats to Poland's political stability.

Revising the Economic Plan

More for the Consumer

The continuing threat of consumer unrest forced the Polish leadership to revise the 1976-80 plan to increase the consumers' share of the pie and lower the foreign trade targets (see the appendix). In December 1976 the regime announced that agriculture, housing, communal services, and the food industries will receive 45 percent of total investment during the period, compared with a 35-percent target in the original plan. Production for the domestic market is to increase 60 percent, instead of 42 to 45 percent, and consumer services are to grow by 70 percent versus the original 49 percent. Not all the changes, however, were good news to the consumer. Because of the intensity of the livestock problems, livestock production and meat consumption targets were cut.

Poland's efforts to meet the revised plan have had mixed results. National income last year failed to grow at the planned rate of 5.7 percent, largely because of the stagnation in agricultural production. The increase in industrial production, on the other hand, hit 8.6 percent, exceeding the 1977 plan rate of 6.3 to 7.3 percent. Meanwhile, the regime attempted to freeze total investments in 1977. Even so, the revised investment plan was not met because there was a greater shift of funds from heavy industry to what Warsaw perceived as more urgent areas of housing, consumer industries, and the food program.

Information available on the 1978 plan suggests that Warsaw already is retreating somewhat from the goals set for 1980. National income and industrial production, for example, are slated to grow at rates of 5.4 and 6.8 percent, respectively—well below the average annual rates of the five-year plan. The 1978 plan restates the freeze in total investment and its restructuring with emphasis on housing construction, food production, and other consumer oriented areas. As the leadership continues to stress consumer welfare, increased expenditures in this area will have to be at the expense of economic growth. The revised 1980 goals for livestock production still stand though their achievement is recognized to be "a very difficult task."

Bigger Role for the Private Sector

Perhaps the most striking feature of the revised 1978-80 plan—representing a reversal of past government policy—is the expansion of private activity in the consumer services sector. The leadership hopes that the private sector will provide the bulk of the growth in the supply of services during the remainder of the plan period. To stimulate this expansion, the government:

- Raised the tax-free limit on private service income by 500 percent.
- Reduced taxes on private business.
- Increased the availability of credit to private business.
- Included private craftsmen in the social insurance system.
- Established local government offices to assist private craftsmen in locating commercial premises and obtaining materials and equipment.
- Created a new government entity to import small tools and equipment to help expand private services.

More Realistic Trade Goals

The original five-year plan called for total exports to the West to grow more than 20 percent annually, pushing trade into balance in 1979 and into a $1 billion surplus in 1980. By the end of the 1976, however, trade targets were revised as Poland was confronted with a decline in some goods available for export and continued weak Western demand for Polish goods. Overall export targets were cut from an annual rate of 15.6 percent to about 12 percent and import growth from 9.4 percent to less than 5 percent. Though undefined, trade targets with the West were accordingly reduced.

Despite these cuts, the revisions still allowed for balanced trade with the developed West by 1980. But this goal required exports to grow 15 percent each year and imports not to grow at all. In 1976, exports grew only 11 percent while imports grew 9 percent, yielding a record hard currency trade deficit of $3.3 billion. In 1977, exports to the developed West grew almost 9 percent but imports fell about 8 percent. The obvious inability to achieve the revised export goal forced its abandonment. The 1978 plan, for example, calls for exports to grow only 9.2 percent and imports 1.4 percent. Now, however, Minister of Foreign

Trade Olszewski is pushing even harder to reduce the deficit and has called for Poland to cut imports by more than 3 percent in 1978 while striving for an increase of 10 to 12 percent in exports for the balance of the plan period.

Even with zero import growth in 1978-80, however, Poland still might achieve its economic growth plans for the remainder of the decade. Because domestic investment is to increase slowly (3 percent annually, compared with 18 percent annually in 1971-75), imports of Western machinery and equipment—almost 40 percent of Poland's hard currency imports—will be curtailed. But this cut should have little adverse short-run impact on economic growth during this period because of a large supply of equipment in the pipeline and some excess plan capacity.

Agriculture—a Key Problem Area

Even with increased investment, agriculture will remain a major problem over the next few years. Good, or even normal, weather could bring grain and fodder production to record levels, but sizable imports of animal feeds still would be required. Without these imports, Warsaw will be unable to achieve sufficient growth in livestock production to reach the consumption target for 1980. Moreover, the leadtime required to rebuild livestock herds means that meat production probably will not increase before mid-1979. Thus, large imports will have to continue if the regime is to satisfy even the 2-percent increase in meat supplies planned for 1978.

Achievement of the 1980 target for agricultural output would require growth rates of 5 to 6 percent compared with the average rate of 2 percent during 1966-70 and 4 percent during 1971-75. Crop production, for example, would have to grow by 6.3 to 7.5 percent annually in 1978-80 compared with a long-term average of less than 3 percent. Poland would have to experience an unlikely three years of better-than-average weather to come even close to these targets.

Even if meat supplies increase, frequent retail shortages will continue if the government does not raise prices and/or cut income growth—two steps the regime has been either unwilling or unable to take. Gierek has refused to raise official meat prices. In January 1978 he said that such prices would rise gradually and would be linked to increased agricultural output. Meanwhile, to help soak up some excess purchasing power, the regime opened a number of "commercial" shops offering a better selection of higher quality meat, but at prices nearly double the "frozen" prices. The reported popularity of the new shops, especially in urban areas, has established a de facto two-tier meat pricing system in the socialized sector. Even so, larger supplies of other consumer goods still will have to be made available to sop up a large part of the workers' excess income.

Potential for Increasing Exports

To help deal with its economic problems, Poland must increase its export earnings substantially. Recent export trends highlight the difficulties facing Poland in diversifying its exports while increasing such traditional exports as coal, copper, and foodstuffs. We project a growth of export volume over the next few years of 10 to 12 percent at best, a growth rate well below that originally planned but consistent with what Polish officials believe feasible.

Foreign Trade Minister Olszewski recently directed that export policy concentrate on coal, copper, and traditional exports which could yield faster results than the broad diversified approach previously promoted by Polish planners. Coal exports, now valued at $1 billion, thus will continue to be Poland's largest hard currency earner. But Warsaw will find it difficult to boost coal exports rapidly because of capacity constraints and rising domestic demand. Substantial increases are not likely until the mid-1980s, when production in the Lublin mines is to be well under way. Most of Poland's sizable copper potential also requires a long period of development. Meanwhile, the industry faces low world prices. Boosting of Poland's traditional food and live animal exports is hampered by rapidly rising domestic demand, by physical constraints on growth in this sector, and by Western trade barriers.

Polish planners originally anticipated that a good deal of the targeted growth and diversification in exports to the West in 1976-80 would come from the plants built with the machinery and equipment imported from the West. Such industries, never before significant in Poland's hard currency export structure, included heavy machinery, chemicals, automobiles, construction equipment, and aircraft. Poland also invested heavily in the production of household appliances and electronics and in such import substitution industries as steel, cement, and pulp and paper.

With the sharp cut in the growth rate of exports to the West, some Polish economists now question whether Poland has created an industrial structure that, while not generating large exports to the West, will still remain dependent on increased inputs of Western raw materials. The lackluster performance of the automotive industry undoubtedly supports their pessimism. The expansion and modernization of the industry, begun in the late 1960s, is based almost wholly on West European equipment, technology, and licenses. Despite its early start, the industry continues to run deficits in its trade with the West. Exports of passenger cars have leveled off at about 21,000 units despite 30-percent annual increases in production. At the same time, imports of auto parts are now about five times those of exports. Trade in buses, trucks, and trailers also has been in deficit. The payoff in exports from some of the projects was not envisaged until much later, however. A 1972 agreement with the Austrians, for example, did not provide for Polish exports of trucks until 1980.

Similarly, the payoff in exports from other projects was not envisaged until at least 1978. Many of the chemical plants built with Western equipment will only come onstream this year. Also, production of Ursus tractors using UK licenses was not to enter series production until 1978. Substantial increases in aircraft sales were not envisaged until the 1980s. The production of components for tracked vehicles, begun in 1972 under a US license, only recently has expanded into the manufacture of complete vehicles—including bulldozers, tractors, earth dumpers, and pipelaying tractors—and has become a net earner of foreign exchange.

On balance, Poland's prospects are mixed for realizing its plan to broadly diversify its export structure. Olszewski's recent directive to concentrate on more traditional goods deemphasizes the policy at least for the short run. Meanwhile, when most of the "new" production is available for export, it will represent technology that is five to 10 years old. Moreover, it will have to penetrate markets that are saturated. A recent survey of technology transfers to CEMA countries, including Poland, from West German firms shows that 50 percent of the coproduction deals involved goods that already face saturated Western markets and another 44 percent involved goods that are moving in that direction.

Other problems the Poles face that may restrict the expansion of exports to the West, particularly of machinery and chemicals, include:

- Tariff and nontariff barriers to Western markets.
- The inability of Polish production to adjust rapidly to change in foreign demand.
- A lack of marketing, servicing, and advertising expertise as well as problems in supplying replacement parts.
- Competition for petrochemical markets from newly developed industries in other East European countries and members of the Organization of Petroleum Exporting Countries.

Balance-of-Payments Outlook

With exports likely to grow at most 12 percent annually and with debt payments mushrooming, Poland will have to cut imports further. Warsaw will find it difficult to raise large financial (untied) credits on a continuing basis even if Western banks remain highly liquid. In fact, some banks now are even reluctant to provide project-related loans to Poland. Moreover, the Poles themselves are anxious about the size of their debts and are reluctant to see their obligations continue to rise rapidly. If, for example, imports are held at the

1977 level and exports grow 10 to 12 percent a year, service payments could consume more than 80 percent of export earnings by 1980. Thus, unless Warsaw obtains large-scale financial credits—either from Western governments or private banks—it will have to resort to rescheduling or cut its imports sharply.

In looking at long-term prospects for Poland's balance of payments, we have developed scenarios that show Poland's import capacity under different export assumptions. One scenario assumes no debt rescheduling (see table 7). Another scenario assumes that one-half of repayments due in 1978-80 are postponed for three years and then repaid over eight years (see table 8). In both cases, upper limits have been placed on the ratio of debt service to exports. It is assumed that this ratio can go no higher by 1980 than the 60 percent incurred in 1977 and must drop to 40 percent by 1985. Historically, few countries have run a 50-percent debt service to export ratio for any length of time.

Assuming no rescheduling and a 12-percent average annual increase in exports, imports would have to fall about 40 percent by 1980 in order for the debt service ratio not to exceed 60 percent. Only if exports grew more than 18 percent a year through 1980 could Poland hope

Table 7

Poland: Import Capacity in Trade with the Developed West Without Debt Rescheduling [1]

Million 1977 US $

	1977 [2]	10-Percent Average Annual Export Growth 1980	10-Percent Average Annual Export Growth 1985	12-Percent Average Annual Export Growth 1980	12-Percent Average Annual Export Growth 1985	15-Percent Average Annual Export Growth 1980	15-Percent Average Annual Export Growth 1985
Imports	6,120	3,160	14,120	3,690	14,710	4,660	16,360
Exports	3,660	4,870	7,850	5,140	9,060	5,570	11,200
Net hard currency debt [3]	12,800	10,200	23,500	11,200	24,700	13,200	28,300

[1] Assuming a ratio of debt service to exports of 60 percent in 1980 and 40 percent in 1985.
[2] Preliminary.
[3] End of year.

Table 8

Poland: Import Capacity in Trade With the Developed West With Debt Rescheduling [1]

Million 1977 US $

	1977 [2]	10-Percent Average Annual Export Growth 1980	10-Percent Average Annual Export Growth 1985	12-Percent Average Annual Export Growth 1980	12-Percent Average Annual Export Growth 1985	15-Percent Average Annual Export Growth 1980	15-Percent Average Annual Export Growth 1985
Imports	6,120	6,410	5,940	7,180	6,960	8,560	8,780
Exports	3,660	4,870	7,850	5,140	9,060	5,570	11,200
Net hard currency debt [3]	12,800	20,000	14,100	21,200	16,100	23,300	19,800

[1] Assuming that one-half of debt repayments falling due in 1978-80 was rescheduled. Repayments begin after a three-year grace period and run for eight years. The debt service to export ratio was held at 50 percent in 1980 and 40 percent in 1985.
[2] Preliminary.
[3] End of year.

to keep imports from falling below the 1977 level. After 1980 (assuming exports continue to grow 12 percent a year), a rapidly growing trade surplus, together with a probable increase in credit because of the improved balance-of-payments position, could be sufficient to allow a significant rise in imports.

A rescheduling of one-half of repayments falling due in 1978-80 would considerably improve Poland's import capacity through 1980. Thus, if real exports grew 12 percent a year, import capacity would rise 17 percent over the 1977 level. But rescheduling on this order of magnitude would increase repayment obligations after 1980, reducing import capacity temporarily. By 1985, import capacity would still be 3 percent below the 1980 level.

The Economic Dilemma—Insoluble in the Short Run

If the Poles cannot arrange sufficient aid or debt rescheduling they will have to make further cutbacks in imports and economic growth. Warsaw probably will have to accept a combination of some financial assistance and import cuts. Although cuts in machinery and equipment imports may not have much immediate adverse impact on output, the Poles also may have to reduce imports of industrial materials. With rescheduling or large rollover credits, higher import levels can be maintained and the ultimate impact on growth could be reduced and/or postponed.

The main impact on the consumer of a cutback in economic growth would be reduced growth of wages and other worker benefits. The regime is committed to increasing the availability of consumer goods and services. It cannot appreciably cut imports of Western consumer goods because of the low level of such purchases. A high level of grain imports will have to be maintained, even with normal production, to raise the amount and quality of meat consumed. Poor harvests would make it extremely difficult for the government to exercise its import options.

Import and growth problems are likely to become more severe after 1980 as expected difficulties in Soviet oil production become considerations. If, as we believe, Soviet oil exports to Poland either level off or fall after 1980, the Poles will have to import large amounts of expensive Western oil. By 1985, such imports could range between \$1.5 billion and \$3 billion, depending on the amount and price of Western oil imported. Some of this might be offset by higher coal prices, but overall Poland would be squeezed for funds to import goods other than oil.

For political reasons, the Polish leadership is reluctant to abandon its rapid growth policies. Gierek's tenure as party leader has been marked by rapid economic growth with a concomitant rapid rise in the standard of living. To abandon this strategy now would mean a discrediting of his past policies and would enhance the chances for his ouster.

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Appendix

Poland: Original and Revised Versions of the 1976-80 Plan

		Original Plan [1]	Revised Plan [2]
National income	Percent average annual increase	7.0- 7.3	7.0- 7.3
Industrial production	Percent average annual increase	8.2- 8.4	8.2- 8.4
Machinery and equipment	Percent average annual increase	10.5-10.8	10.5-10.8
Chemicals	Percent average annual increase	10.9-11.2	10.5
Wood and paper	Percent average annual increase	8.2	9.2
Consumer goods	Percent average annual increase	6.2	6.5
Foodstuffs	Percent average annual increase	6.2- 6.5	7.1
Agricultural production	Percent average annual increase	2.8- 3.0	3.0- 3.5
Crops	Percent average annual increase	2.3- 2.8	3.4- 3.9
Livestock	Percent average annual increase	3.0- 3.4	2.7
Hogs	Million head	23 [3]	21-22 [3]
Cattle	Million head	14.7-15.0 [3]	14.0-14.3 [3]
Capital investment			
Total economy	Percent average annual increase	6.5- 7.9	7.4
Industry	Percent average annual increase	7.4	8.9
Agriculture	Percent average annual increase	5.5	7.9
Housing	Million units	1.525 [4]	1.575 [4]
Real wages	Percent average annual increase	3.0- 3.4	3.0- 3.4
Social benefits	Percent average annual increase	8.3	11.2
Per capita meat consumption	Kilograms	79-81 [3]	75 [3]
Total trade			
Exports	Percent average annual increase	15.6	11.8
Imports	Percent average annual increase	9.4	4.7

[1] As announced at the Seventh Party Congress in December 1975.
[2] As announced at the Fifth Plenary Assembly in December 1976.
[3] Target for 1980.
[4] Target for 1976-80.

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