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The Polish Economy

The Polish economic crisis has deepened in recent months, and the Party Congress has not produced an economic program to bring recovery. (U)

- The decline in industrial output has not halted.
- Food shortages remain severe and are likely to worsen.
- Poland's hard currency squeeze has forced cutbacks in imports of industrial materials and spare parts needed to keep industry going.
- Negotiations on rescheduling Poland's private, non-guaranteed debt could drag on and the Poles, in fact, may be stalling to avoid the payment of some \$1 billion due on the signing of the agreement.

(C)

The nature of the Polish economic crisis and prospects for resolving some of the problems are explored in the following questions and answers. (U)

How bad is the food supply situation?

Food shortages--the worst in recent memory--remain severe and are contributing to labor unrest. Meat production in January-June 1981, for example, was more than

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20 percent below the level of first half 1980. Nationwide rationing of meat, butter, sugar, grain products other than bread, and infant food products has somewhat improved the equitability of food distribution, but food lines remain long. Although foodstuffs have practically disappeared from state store shelves, apparently no one is going hungry since more supplies are now handled through the thriving private and black markets. The causes of the breakdown of the state retail market system not only include supply-side problems but excess demand--spurred by rapid wage increases--and by panic buying and hoarding. Shortages of most foodstuffs are at least not likely to worsen this summer as seasonal products--fruits, vegetables, and potatoes--continue to come on the market. We estimate that in mid-summer 1981, per-capita food consumption was down about 10 percent compared with July, 1980. (C)

What are the near term prospects for industry and agriculture

Shortages of raw materials and spare parts, the shortened workweek, and lower productivity will contribute to about a 17 percent drop in industrial production in 1981. All sectors of the economy--especially the coal sector--are experiencing declines in output. Production of coal, a major hard currency export, will probably decline

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about 18 percent from the 1979 high of 201 million tons. The domestic economy as well as the export market will suffer as a result. (U)

Prospects for Poland's 1981 grain crop are good. Favorable weather and higher procurement prices point to increases in most crops. The outlook for meat supplies in the coming years, however, is bleak since it will take 3 years for production to return to levels of the late 1970's. Earlier this month, the regime acknowledged that meat rationing commitments for July will be satisfied only by using the remainder of the meager state reserves. Without meat reserves or the funds needed to buy large amounts of meat from the West, Warsaw will be unable to cover present allocations for the next several months. (U)

What is the status of negotiations to reschedule the unguaranteed debt?

After six months of tough negotiations, Western banks agreed in late July on rescheduling terms. The Poles' preliminary reaction to the banks' proposal has been negative, indicating that talks could drag on for some time. In fact, the Poles now may be stalling to avoid the payment of roughly \$1 billion due on the signing of the agreement. Meanwhile, the informal moratorium on principal payments in effect since 26 March continues in effect and

Warsaw is falling further behind in interest payments. The risk that a bank will declare Warsaw in legal default is reduced somewhat by the fact that default could hurt the banks more than the Poles, and by the limited damage that default could inflict on Warsaw's already desperate financial position.

What does Poland need most from the West in the next several months of 1981 and into 1982?

Warsaw's most pressing needs are for 215,000 tons of meat (worth \$452 million) to fulfill ration requirements in September 1981-June 1982 (150,000 tons or \$242 million through December); b) 4.3 million tons of grain (in addition to deliveries already arranged) and 1.5 million tons of oil meal and oil seeds (worth a total of \$1.1 billion) through June 1982 to sustain the recovery of livestock herds; and c) about \$1 billion in cash or credits to service its debt and avoid default.

Agricultural Goods

Some of the meat and grain imports have already ordered and the financing arranged. Some 50,000 to 60,000 tons of meat contracts have been committed by the EC but delivery awaits financing arrangements. Including the recent US corn sale of 350,000 tons of corn, about 2.14 million tons of the July 1981-June 1982 need for grain has

been met. Poland also needs up to \$1 billion in imports of raw materials and spare parts to overcome bottlenecks in industry.

Industrial Materials

✓ The ^Pimport picture is less clear for raw materials and semimanufactures needed as inputs by Polish industry. The Poles variously projected that they would need \$3.0 billion, \$2.6 billion and \$2.3 billion in 1981. These projections may all be too high because of a sharper-than expected decline in industrial production. Warsaw, however, probably needs more than \$2 billion for 1981 as a whole and perhaps as much as \$1 billion in the last five months of the year.

West Germany and France each granted nearly \$200 million in credit guarantees for steel and chemicals, nearly all of which was used in the first half of the year. Polish data show \$600 million worth of imports of these commodities in the first quarter, which was about on schedule for the year. With Western credits for industrial materials largely exhausted, the Poles have experienced problems in obtaining deliveries. (C)

Spare Parts and Capital Goods

We have numerous reports that the lack of imported spare parts is causing spot production bottlenecks. In most cases, even though they are relatively inexpensive, the

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parts cannot be purchased because of a shortage of hard currency. The ^{total} value of parts involved cannot be estimated ^{let} by it may be small relative to Poland's need for food and industrial materials. For many of these needed imports, Warsaw could probably tap substantial unused lines of guaranteed credits for capital goods; France alone has undisbursed capital goods credits to Poland of more than \$500 million. Moreover, French officials recently inferred that these credits could be used for imports of food and spare parts. (S)

With ^Q Polish investment sharply reduced and major projects mothballed, Warsaw's immediate requirement for machinery and equipment imports is small. Moreover, ample credits for priority items are available from Western Europe and Japan. (C)

What form of aid would be most useful and effective--
credits, cash, agricultural goods, industrial materials?

Rush shipments of meat and other food would do most to directly reduce the risk of Soviet intervention. The augmented market supplies should help calm the situation and perhaps give a psychological boost to the population. Provision of cash or financial credits probably would be used ^fto meet debt-service payments to Western banks rather than to buy the food and other imports which would

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contribute most to stability. West European countries could help substantially by eliminating down payments and broadening the commodity coverage of nearly \$2 billion in guaranteed credit lines which Warsaw is now unable to use. Some countries have already approved some of these changes but they may not be enough.

Are other problems so serious that aid will do little to bring about an economic recovery?

Aid will not alleviate one of Warsaw's most serious economic problems--the reduction in labor input because of the reduced work week, strikes and worker unrest but it could improve worker morale. Other economic problems still remain to be resolved, including structural and systemic obstacles to improving economic performance. Moreover, aid could allow the Kania regime to delay even longer the economic reform needed to mount a meaningful and sustained economic recovery. Finally, the Soviets could invade for reasons not related to the economic situation.

✓ What do we estimate Poland's needs to be through 1985?

For 1982 and the following three years, the bulk of Warsaw's needs will be debt relief of about \$10 billion annually, most of which presumably will be rescheduled. The debt service is roughly evenly split between obligations due to Western governments and those owed to banks. In addition the Poles are likely to continue requests for aid

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and/or credits for food and other imports. The size and commodity composition of the requests will depend on success in economic recovery (which in turn is heavily dependent on Political stability in Poland) and Warsaw's ability to power export growth. Fluctuations in agricultural production particularly will drive Poland's import requirements. In any case, the need for financing for trade deficits will be dwarfed by the requirement for debt relief.

What are the prospects for growth and recovery in the medium term?

Even if funds are provided, economic recovery will be difficult to get started. The government has not yet established the following internal preconditions for renewal:

--As long as the populace views its leaders as self-serving,

corrupt, and incompetent, it is unlikely to put forth greater effort on the production line or accept a standard of living that may stagnate in the next year. (C)

--The failure of past abortive attempts to raise food prices

without sufficient preparation or consultation with workers point up the importance of Solidarity

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cooperation. Solidarity now appears willing to go along with moderate and gradual retail price hikes only if compensation is granted to lower paid workers and other economic reforms are implemented concurrently. (C)

--Warsaw must impose discipline on the investment process,

which is still characterized by local and ministerial defiance of central directives. In addition, the success of the regime's agricultural policy depends on preventing local party officials from undermining programs to enhance the role of the private sector. (C)

Warsaw nonetheless has the basic assets for restoring the health of the overall economy. These include a skilled labor force, abundant natural resources, and a capital stock that a year of peaceful revolution has left underutilized but intact. If the critical industrial inputs are available and Polish workers can be motivated to move where they are needed and to work longer and harder, economic activity would respond fairly quickly. (C)

What measures are needed to stabilize the domestic economy?

Sharp curtailment of capital investment, with the reduced share of investment in GNP reallocated to favor

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previously neglected sectors such as transport, electric power, and agriculture. This appears to be the best way to free resources for boosting net exports and simultaneously preventing a further decline in living standards.

Meanwhile, private agriculture must be encouraged through a variety of means, including legal steps to allow enlargement of individual holdings, more investment, a stepped-up flow of vitally needed inputs such as fertilizer, and easier availability of credit. To reduce the disorder in consumer markets prices have to be raised, and the growth in wages curbed. Again, these policies have to be screened by Solidarity. (U)

What are the chances that the government will be able to implement these measures?

Reducing and reallocating investment, and bolstering private agriculture--policies already underway--involve no potentially destabilizing systemic changes. Restructuring the price system and linking wages with productivity would make good economic sense, but might be a political disaster. Unless such policies are agreed to by Solidarity they could trigger continuing serious unrest. (U)

What are the prospects that the leadership will introduce far reaching, systemic economic reforms?

Since last year's unrest, the Polish leadership has

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strengthened its commitment to reforms of the existing system of economic management. The major directives appear to be decentralization of economic decision making and increased worker participation in the enterprise management. At the same time, the leadership continues to pay lip service to the importance of central planning. Therefore, the regime will have to work out how to balance the authority of the central plan with increasing decentralization and workers' self-management. (U)

Progress on implementation of economic reform would be regarded favorably by Western creditors and by Solidarity. Progress on reform has inevitably been slowed, however, by disagreement over what reforms to adopt. Solidarity, for example, wants enterprise property to be vested in the work force while the government insists that the means of production must belong to society in general. In any event, the difficulty of performing major overhauls on a seriously weakened economy will slow the transition to new economic arrangements. The government needs to be able to intervene quickly in a bottleneck-ridden economy.

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