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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

The Polish Economy: Performance And Prospects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1970

INTELLIGENCE MEMORANDUM

The Polish Economy: Performance and Prospects

Introduction

In 1969 the Polish regime at last decided to overhaul economic planning and management and to push for changes in foreign economic relations, both with Communist countries and with the West. This memorandum considers the economic problems of Poland and the possible economic payoff from the new developments in policy.

Key Features of Polish Economic Policy

1. Poland's postwar economic policy has aimed at transforming a backward and predominantly agricultural country into a modern industrial state. In pursuit of this aim the Communist regime has maintained a high rate of investment, has rapidly expanded the nonagricultural labor force, and has relied on close economic relations with the USSR. Poland today retains these basic economic policies.

2. Fixed capital investment has accounted for a high and growing share of the gross national product (GNP), rising from more than 20% in the early 1950s to close to 30% by the 1960s.* Total invest- 25X1

** Gross investment estimated at factor cost.* [redacted] 25X1 *Figures for net investment as a share of "national income," as given in Polish sources, are slightly lower.* 25X1

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research.

ment, including additions to inventories, now runs at one-third of GNP. Polish industry has had first claim on investment resources, accounting for nearly 40% of total fixed capital investment and an even larger share of additions to inventories.

3. Within industry, investment outlays have been made on a broad and ever widening front. Year in and year out, each of the key Polish industries -- and nearly every one of the enterprises in them -- has received more investment funds, without much regard to the "effectiveness" of prior investments. A large part of fixed capital investment has gone to increasing capacity -- mainly in heavy industry -- and little to modernization.

4. Agriculture has made a relatively small demand on state resources, either for investment funds or for operating subsidies. As a result of Gomulka's decision in 1956 not to proceed with the collectivization of agriculture, Poland has avoided the large expenditures forced on other East European countries by collectivization. Moreover, the regime is less willing to invest in modernizing private agriculture than other regimes are to invest in collectivized agriculture, although substantial investments have been made in producing fertilizer and machinery for agriculture. Relative to the increment in agricultural output since 1950, Polish investment in agriculture is the smallest in Eastern Europe. Although agriculture still accounts for nearly one-quarter of GNP, the share of agriculture in total investment has rarely exceeded 15% and on the average has run less than in other East European countries.*

5. In contrast, investment in construction, transportation, and other services has been relatively large, as a result of rapid industrialization and the big increase in population -- a 30% increase from 1950 to 1968, the greatest in Eastern Europe. To provide minimum housing and public services for

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this expanding population, given industrialization and rapid urbanization, Poland has had to invest more in services than in industry. In constant (1961) prices, the share ran close to 45% until the mid-1960s, when it began to decline.

6. The high rate of investment in industry is related to the rapid growth of the labor force. Total employment grew from 12.7 million in 1950 to 16.3 million in 1968, mainly as a result of an increase in the population of working age -- the net change in participation rates was small. The increase in the urban labor force was even larger, from 5.7 million to 10.2 million, while the agricultural labor force declined by about 900,000. The regime, committed to full employment and industrialization, has tried to make available new jobs in the urban economy for all those seeking work. Industry has shown the most rapid increase, nearly doubling employment from 1950 to 1968 and increasing its share of total employment to more than one-fourth.*

7. In the 1950s, migration from agriculture was the main source of new workers for industry. Peasants in unprecedented numbers left villages and towns in search of city jobs, especially in Warsaw and in the new territories acquired from Germany after World War II. Some two million peasants migrated to urban areas, mostly before 1956 in reaction against the drive to collectivize agriculture.

8. In the 1960s, especially since 1963, the growth of urban employment reflected the postwar "baby boom," which lasted for a decade and a half and gave Poland one of the highest birth rates in Europe. About 300,000 young Poles have entered the labor force in each of the last six years -- more than double the average figure for the previous ten years. Most of them have looked to the cities for work.

9. In the race to increase output per capita for a rapidly expanding population, Poland has relied heavily on the USSR to provide a market for

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its manufactures, especially machinery, and to furnish essential materials. Poland has a substantial resource base, including abundant coal reserves, but imports grain, iron ore and ferrous alloys, and most of its crude oil, mainly from the USSR. Before World War II the bulk of Poland's trade was with Western Europe, only 1% with the USSR. Now the USSR is Poland's chief trading partner, accounting for at least one-third of total foreign trade turnover, a share greater than that of the entire Free World.

10. Like the other East European regimes, the Polish regime originally sought close economic relations with the USSR as a basis for planning economic growth, a basis that would permit Poland to expand output with little regard to demand on the world market. As a result, after two decades of insulation from the Western market, Poland has developed major lines of manufactures that are readily saleable in large amounts only to Communist trading partners and, on occasion, less developed countries. Machinery and other finished goods make up about two-thirds of total sales to these markets. On the other hand, foodstuffs, raw materials, and intermediate manufactures make up two-thirds of sales to the industrial West.

Economic Trends*

11. Under these policies Polish economic growth has been fairly rapid, averaging about 4.7% per year since 1950 (see Table 1). On a per capita basis, however, the average annual rate of increase in GNP has been only 3.2%, the lowest in Eastern Europe. This low rate reflects the 30% increase in population and the high costs of urbanization. Mistakes made in the early 1950s, stemming largely from an overconcentration of resources in heavy industry, also contributed to a low rate of growth.

12. During the 1960s the growth of population slowed down and the per capita rate of annual

* *The estimates used here to measure growth do not reflect the Polish growth indexes; they reflect indexes calculated for comparability with Western data.* 25X1

Table 1

Average Annual Rates of Growth of GNP, by Sector of Origin a/

Percent

	1951-60	1956-60	1961-65	1966	1967	1968 b/	1969 c/
Industry and handicrafts	8.7	7.7	6.9	5.4	6.6	8	7-1/2
Agriculture and forestry	1.9	2.7	1.7	8.9	-0.7	4	-4.7
Construction	8.2	5.4	3.6	5.8	8.5	6	N.A.
Transportation and communications	6.7	5.1	6.7	16.9	7.7	7	N.A.
Trade	5.3	7.6	5.3	7.0	7.5	6	N.A.
Housing	2.3	3.0	2.5	3.8	2.9	3	N.A.
Other services	1.5	0.4	4.5	3.1	3.8	3-1/2	N.A.
GNP	4.6	4.6	4.5	7.1	3.6	6	3-1/2
GNP per capita	2.8	2.9	3.2	6.5	3.3	5	2-1/2

a. Estimates through 1967 [redacted] 25X1
b. Estimated.
c. Preliminary.

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growth rose, from 2.8% -- the average for the 1950s -- to 3.8%. But the regime takes little comfort in that, for the growth of output per worker was slower in the 1960s. Employment, which rose more slowly than population through 1959 -- at only 1% per year -- has since been growing faster. The divergence has been especially marked since 1963, when the postwar "baby boom" mentioned above brought the annual increase in employment to nearly 2%, for the more rapid growth of employment has not brought much rise in the rate of growth of output. Thus the annual increase in labor productivity, which averaged almost 4% in 1956-60, ran in the 1960s at only about 3%.

13. The overall growth of efficiency is also discouraging. To be sure, the capital/output ratio has declined very slightly, instead of rising, as it did in most other European countries in the 1960s. The value of all fixed capital, according to official figures (at constant prices) has been increasing at about 4% per year. But even so the combined productivity of capital and labor has been going up at only about 2% per year, not an impressive figure for a relatively backward country.

14. Economic growth in the 1960s reflected a slowdown in industry and a rise in growth rates in construction and transport and communications. The growth rate in industry and handicrafts is down from the late 1950s -- though it has tended to rise in recent years -- because of a drop in rates for light and food industries and some slowdown in the growth industries, notably electrical and electronic equipment. The main cause was a leveling off of demand for the available product mix -- and lags in adapting the product mix to demand. In agriculture the growth rate declined in the early 1960s and has fluctuated sharply since then. In construction a slowdown in the early 1960s has been followed by an upswing since 1965. In transport and communications, growth in the 1960s was actually faster than from 1956 to 1960. In all these sectors, in contrast to industry, investment has been up sharply. In agriculture, the regime has been investing heavily in grain production since 1964 to reduce dependence on imports, especially from the West -- the combined result of a drop in Soviet deliveries in 1964 and the end of US deliveries under PL 480.

As a result, production has increased substantially, subject to variations in the weather, but industrial inputs have risen even faster, and the average rate of growth of value added in agriculture is still low, as it is generally in Eastern Europe. The upswing in construction and the sharp rise in the output of transport and communications reflect attempts to break bottlenecks in the economy. Trends in other services have been mixed, with a slight decline in the growth rate for housing and trade and a rise in the growth rates for public services, including defense.

Symptomatic Problems

15. The symptoms of the slower growth of efficiency in the 1960s are those common to the Soviet and East European economies in this period -- a large rise in money incomes and chronic shortages of consumer goods; bottlenecks in construction and transportation; and a lag in modernizing plant, equipment, processes, and products, as reflected especially in exports.

16. One important symptom of Poland's economic difficulties is that managers persist, counter to plan, in increasing employment so as to meet production quotas. A slight relaxation of central controls in the 1960s has doubtless aggravated the problem. Because many plant managers hire labor indiscriminately as a cheap substitute for capital, any Pole who wants to work can usually find a job, almost without regard to experience or work record. The ease of getting work has contributed to lax labor discipline. Absenteeism is high; Polish industrial workers in 1968 stayed away from the job an average of fifteen working days.

17. An indication of the strong demand for labor is the ease with which Polish women, eager to augment low family incomes, have been able to find work, not only in light industry and the services but also in heavy industry, even in construction. During 1966-68, 58% of all new workers were women -- a percentage much higher than the 43% ceiling written into the plan. The proportion was already high -- 54% -- in the years 1961-65, a sharp jump over the 1950s, when it was only 38%. The regime's

hope of reducing the share in 1966-68 obviously came to nought.

18. All in all, about 200,000 more workers entered the work force in 1966-68 than the plan allowed for, and there were also wage increases above plan, so that total wage payments were much more than planned. In each of the years 1965-68, total wages rose by more than 7%, placing a growing strain on the consumer market, aggravating existing shortages of some goods and resulting, finally, in price hikes for a number of important commodities. The price of meat, the single most important item in the Polish food budget, was increased by 17% in late 1967. The growing imbalance between purchasing power and supplies of food and desirable consumer goods could have brought even more serious consequences had not the regime succeeded in encouraging the people to save for an apartment or a car. Savings deposits have grown at an average yearly rate of 20% during the last five years, although total savings are still relatively low for Eastern Europe, about one-third of the annual wage bill.

19. Equally serious difficulties appeared on the investment front, as the cumulative effect of starting too many projects for the available resources. By the end of 1968, [redacted] 25X1
[redacted] 200 billion zlotys -- some $5 25X1
billion* -- were tied up as "frozen assets" in incomplete investment projects -- a sum greater than one year's investment and a large jump over the previous year's total. Gomulka hardly overstated the case in characterizing the investment process as "planned disorganization in advance." Large resources are tied up in some projects, such as the Polish FIAT plant at Zeran on the outskirts of Warsaw and the Olsztyn tire factory, which represent important additions to the country's capacity for producing automotive equipment and farm tractors. The investment cycle, according to another account, has grown from four to six years in the Warsaw

* *It should be noted that $5 billion, although equal to more than one year's investment, is less than 15% of the estimated dollar value of GNP. The zloty/dollar ratio for investment of about 40 to 1 is much higher than for GNP as a whole.*

industrial region as a whole -- the third most important industrial region in Poland -- and stretches out to eight to ten years for some undertakings. There are serious delays, moreover, in bringing finished plants to full capacity operation.

20. The long investment cycle results partly from the practice of industrial planners of understating enormously the probable costs of projects so as to improve chances for acceptance. [redacted] actual investment costs during 1966-68 ran 65% above plan for the country as a whole. In contrast, the unallocated investment reserve is 5% of the total planned amount.

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21. Lags in construction -- aggravated by bottlenecks in the country's primitive transportation system, especially the railroads -- have not been helped by chronic shortages of gravel, structural steel, and cement. The cement shortage assumed critical proportions by the early spring of 1969, and the cement plants changed over to a four-shift work day. Cement exports have also been cut back, from 45,000 tons per month on the average during 1966-68 to only 5,000 tons per month during the first nine months of 1969.

22. The technical obsolescence of many or most Polish exports is another major problem of concern to the leadership, especially in regard to machinery, which in 1970 will contribute nearly 40% of total exports. Many of the machinery industries are oriented to the export market. For example, 40% to 50% of the output of metalworking machine tools, diesel engines, excavators, and freight cars has been exported in recent years, and 70% of the output of the shipyards. These products alone accounted in 1968 for nearly one-fourth of machinery exports, the other main categories being complete industrial plants (12%), power installations and electrical equipment (8%), and motor vehicles (5%). The rest is scattered among the other branches of machine building. Most of these exports are still sold readily enough in Communist countries -- in exchange for other machinery -- but not on the world market.

23. Poland's difficulty in marketing machinery in the West is suggested by the low prices obtained

for it and by the relatively small amounts sold. According to data for 1964, the average per kilogram price brought by Polish machinery is substantially lower than the average for Eastern Europe as a whole -- though 15% to 20% above the average price of Bulgarian and Romanian machinery -- and less than one-half the average per kilogram price in transactions between West European countries. Per ton, Poland pays up to five times as much for machinery imports from the West as it receives for its exports -- the difference being twice as great as in trade with other Communist countries. These contrasts reflect differences in product composition (Poland exports chiefly industrial machinery, which has a relatively low value per pound), the heavier weight of machinery of Polish design, other less desirable features of the products themselves, and poor marketing and service. As a result of these problems, Poland has not succeeded in selling much machinery in the industrial West, barely 3% of its total machinery exports, and only some 3% of its total exports to the industrial West.

24. The realization of how backward Polish technology is led the regime in 1966-68 to step up imports of investment goods, especially from the West. Imports of machinery, in 1956-60 only 24% to 33% of total imports, rose to 29% to 37% of imports in the 1960s, and the share is rising. The share of the industrial West in imports has been rising and now represents more than 20%. Since the mid-1960s Poland has bought more machinery from the West on credit than ever before -- at least \$215 million in long-term credits during 1966-68 -- although its policies on credit purchases remain quite conservative. As a result especially of the step-up in purchases from the West, machinery imports now account for nearly one-third of the total investment in machinery and equipment.

Targets for Economic Growth in 1971-75

25. The constraints imposed on Polish economic policy in the 1960s will remain effective in the 1970s -- a large number of new entrants to the labor force, the difficulty of controlling employment and investment, and technical backwardness. Therefore, the present Polish leadership intends to

aim for about the same rates of growth as in the late 1960s, using the same basic policies -- maintaining a high rate of investment, allowing a large increase in nonagricultural employment, and relying heavily on trade with the USSR.

26. The rates of growth of output, employment, and investment planned for 1971-75 are only a little higher than those projected in the current five-year plan. The main features of the plan that differ sharply from those in 1966-70 are a higher rate of growth in foreign trade, especially in imports, and a much smaller increase in agricultural investment. A comparison of the preliminary 1971-75 targets with those for 1966-70 is given in Table 2. Actual economic development in 1966-69 was quite close to the planned growth, except for the unplanned increases in employment and foreign trade and some underfulfillment of agricultural plans. Probably, therefore, the 1971-75 plan involves little projected change from actual rates in the present period -- except for reducing the growth of employment.

27. From what is known of the gross structure of output, investment, and trade, the general trends of the recent past are to be continued. Priority will still be given to increasing output of machinery, electronic equipment, building materials, and chemicals -- as in every other Communist country. Investment will be concentrated on the development of output in these areas of industry, and investment in services (except for transportation) will continue to lag, as it has since 1965. As in the last few years, export strategy will be (1) to push development of sales of machinery and, to a lesser extent, of consumer goods, (2) to hold down exports of agricultural commodities and foodstuffs, and (3) to develop exports of selected raw materials and intermediate products. Machinery and industrial materials are due to provide an increasing share of imports; foodstuffs and consumer goods, a declining share. The preliminary goals for increasing foreign trade by 1975 are shown in Table 3.

28. The main targets for economic growth probably can be met even if the regime is not successful in introducing new technology as planned. The introduction of new technology is in the nature of

Table 2

Preliminary Plan Targets for 1971-75
Compared with Plans for 1966-70

	Annual Average Percentage Increase	
	1971-75 Plan	1966-70 Plan
National income a/	6.3	6.0
Industrial production b/	7.7-8.0	7.6
Agricultural production c/	2-3	2.6
Foreign trade		
Exports	8.2	5.9
Imports	8.7	5.1
Investment	7.0	6.6

a. Differences in coverage and computation from GNP.
b. Official gross industrial production, not calculated value added in industry and handicrafts.
c. Gross output of crops and livestock (not value added in agriculture as in Table 1). The rate of growth of agriculture projected for 1971-75 is inferred from published discussions; no explicit statement has yet been made.

an investment in the economic future of Poland, which is not likely to be reflected in higher growth rates in the short run. Indeed, the attempt to upgrade products and stimulate efficiency -- and to improve the infrastructure in transport and trade -- could well lead to a slowdown in growth, for success in achieving these objectives is not immediate and depends on making planners and managers -- and the leadership -- less concerned with meeting plan targets for output.

Table 3

Increases Projected in Polish Imports and Exports
1975

	Imports			Exports		
	Index (1968 = 100)	Index (1970 = 100)	Commodity Composition (Percent)	Index (1968 = 100)	Index (1970 = 100)	Commodity Composition (Percent)
Machinery and equipment	211	168	42	225	179	49
Fuels and industrial materials	168	144	44	131	100	25
Foodstuffs and agricultural products	142	131	9	100	100	8
Industrial consumer goods	150	123	5	187	168	18
Total	*180*	*150*	*100*	*189*	*151*	*100*

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Recent Changes in Planning and Management

29. The Polish regime -- it hardly need be said -- has no intention of experimenting with untried economic reforms, involving widespread layoffs of workers, sharp price rises, or balance-of-payments difficulties. Throughout the reform movement of the 1960s Poland hung back. Gomulka has no sympathy with the "revisionist" economic ideas that he faced on coming to power in 1956. Nor would it suit him to announce a sweeping program such as that launched by Walter Ulbricht in 1963, although his ideas on reform are not far from Ulbricht's. The reforms Gomulka introduced in 1969 in fact came only after a serious challenge to his leadership mounted the previous year and led in part by Politburo-member Edward Gierek, the industrial czar of Katowice province and the spiritual leader of Poland's "young technocrats." Gierek and his followers especially criticized the cumbersome administrative apparatus in Warsaw that hamstrung efficiency in production units and, by implication, the aging bureaucrats that made the apparatus go round.

30. To this, Gomulka responded by introducing reforms intended chiefly to make the central authorities more effective through the replacement of key personnel and emphasis on economic decision making and deemphasis of monitoring production. The enterprise managers, although freed of obligatory quotas for production in physical terms, do not have much room for maneuver. In regard to employment, wages, and investment, their freedom has been reduced rather than increased. These changes have been introduced with a well-publicized campaign of familiarization but Gomulka does not claim and presumably does not expect any dramatic economic results. However, he did succeed in blunting the arguments of his most powerful critics at least temporarily and gained a period of grace that should carry him at least through the early years of the 1971-75 plan.

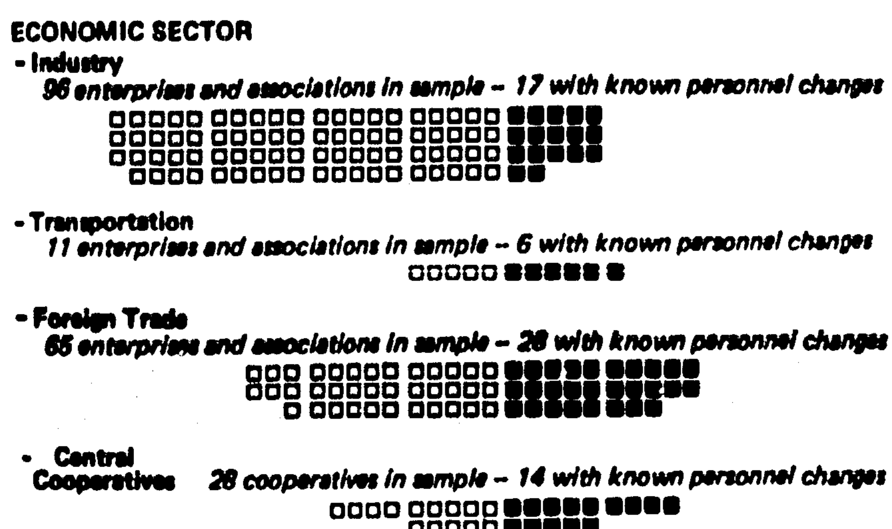
31. Changes in planning and management were preceded by widespread changes in the economic hierarchy beginning in December 1968. Since then the entire top echelon of the State Planning Commission -- the organ most responsible for overseeing

the economy -- has been replaced, beginning with the removal of Stefan Jedrychowski, whose heavy-handed administration dominated the economy for well over a decade. Both the new minister (Jozef Kulesza) and his leading deputy (Jozef Pajestka) have been selected more for their professional abilities than for their standing in the Party; they are not even known as Gomulka men. Each has emphasized the urgency of industrial specialization.

32. Wholesale personnel changes also have been made since early 1969 within the Ministries of Foreign Trade, Shipping, Finance, Communications, and Building and Building Materials -- beginning at the top. In almost every instance, new appointees are younger, display better professional credentials, and have more management experience than their predecessors.

33. At the operating level, in the associations and enterprises, there has also been a considerable turnover in management. Since the Fifth Party Congress in November 1968, new heads have been appointed in about one-third of the operating organizations for which information is available (65 out of 200). Turnover has been greatest in the central cooperatives and in transportation and foreign trade. In industry, only one of six managers has been replaced (see the accompanying chart). Appoints to management jobs in industry

Personnel Changes Made at the Director and Deputy Director Level in Associations, Enterprises, and Central Cooperatives September 1969



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are influenced by the powerful Party leaders in the provincial capitals, and the central authorities must move slowly in this area.

34. The reforms introduced this year do not give a great deal of additional leeway for decisions by management. Physical production targets are no longer binding, and enterprises will be somewhat more free to produce according to demand. But their freedom to change the product mix will still be limited by many factors. These include dependence on central allocation of key materials and central approval of investment in new machinery. They also include obligatory quotas for the value of output and exports. Enterprises must meet targets for the value not only of total output but also output in key commodity groups. The value of exports also remains an obligatory quota -- presumably in terms of foreign exchange earned by sales of various groups of commodities.*

35. Profits do not play an important role as indicators in the Polish reform. Prices are still set by the central authorities. Enterprises may retain for investment a substantial share (46%) of profit, but ceilings are placed on investment outlays, however large the profit available for investment.

36. Finally, there are two new controls -- (1) on the level of employment and wages and (2) on the initiation of investment expenditure. These controls, which are discussed at some further length below, complete the task of hemming in the enterprise and/or association managers. Enterprises are expected, says the Party, to take a more active role in planning, cooperating with the central authorities. But the tightly restricted field of action of the enterprise should give the manager few illusions about his job, let alone his influence.

<u>Holding Down Employment and Wages</u>

37. After years of bewailing the readiness of managers to hire unauthorized workers and to pay

* *As provided in a reform of 1966. It is not clear whether targets are set for different types of foreign exchange (clearing rubles; accounting dollars, schillings, and the like; and free hard currency).*

wages in excess of quota, the regime in 1969 finally began to take administrative action. Reports over the last year mention severe reprimands, financial penalties, and "changes in the staff" as the means used to enforce "wage and employment discipline." In the fall of 1969 the Polish press announced that these penalties had begun to take effect -- or in "Party Chinese":

> The introduction of certain financial and administrative restrictions as regards employment has given positive results after the unfavorable outcome of the first six months of this year.

The results are not especially impressive -- the increase in employment in the nationalized economy over 1968 in the first three quarters came to 3.3%; in the first half, it had been 3.5%.

38. Little more effective was the setting of employment limits for the end of 1969, as reported in the Party journal *Zycie partii* in October. In some cases enterprises apparently laid off employees to meet these quotas, but the total increase in employment in the nationalized economy for the year was still 3.4%. The goal for 1970 is an increase of only 2.5%, which, with a continued slight decline in private employment (chiefly in agriculture) and little change in cooperative employment (in handicrafts and the building trades), would represent an overall increase of about 1-1/2%, a substantial reduction below rates in recent years.

39. To back up these efforts, the regime has slated 55,000 students for an extra year's schooling; recommended the employment of women only on a part-time basis, especially in trade and the service industries; and added to educational and monetary incentives to keep young people in private agriculture.

40. Although these measures should be effective in the short run, persistent effort will be necessary to control employment over several years. The regime has a good reason for trying to do so -- to ease the inflationary pressures that developed in the 1960s. But there is an obvious conflict between the commitment to leave more to managers and increased administrative pressures to hold down

employment and wages. Pressure will doubtless be reduced or increased according to the growth of food supplies, improvements in the quality and mix of consumer goods, especially durables, and the availability of new housing and other services.

Regulation of Investment

41. The regime has also introduced several changes in the regulation of investment, in order to restrict the proliferation of new projects and to channel more resources into the industries selected for modernization.

42. First, the regime will impose at the outset a ceiling on the amount of investment funds available from the state budget for lower priority industries through the entire period 1971-75. These industries will have to stay within the initial investment allocations. At the same time, the unallocated reserve in the state budget has been increased from 5% to 10% of total investment outlays. This change -- long favored by many Polish economists, including the late Oskar Lange -- seems to be intended to cover unforeseen needs of the high-priority industries.

43. An important check has now been placed on investment by enterprises from their own profits or from bank credits by requiring the approval of the State Bank before undertaking any project. Since a large share of investment comes from these sources -- the share was 65% in 1966 and is expected to grow to 84% this year -- this control, if exercised, could help to reduce the proliferation of investment projects and to encourage priority investment. Whether the State Bank is up to dealing with the job, which has proved too much for the ministries and the State Planning Commission, remains to be seen. But the banks at least have wide latitude in applying sanctions and incentives. They can scale the size and terms of annual repayments, postpone repayments, waive regular interest charges (now set at 3% for investment projects) and make refunds for projects completed ahead of schedule.

Foreign Trade Policy and Technology

44. Finally, the Poles are trying to use the revamped administrative structure to modernize the economy through foreign trade. In particular, they are hoping (1) to increase economies of scale by cooperative agreements with Communist trading partners; (2) to expand output of highly saleable exports, especially for Western markets; and (3) to upgrade processes and products in selected industries by greatly increasing imports of machinery from the industrial West on medium- to long-term credit.

45. The Polish regime has long hoped to arrange for product specialization among the members of the Council for Mutual Economic Assistance (CEMA) on some more effective basis than in the past. The "specialization agreements" negotiated since the late 1950s cover relatively few commodities -- in 1966, only some 6% of machinery products, for example -- and many cover existing patterns of specialization rather than the results of negotiation.

46. Polish hopes of a new initiative in this field were dashed in April 1969 by the failure of CEMA, after discouraging months of deliberation in committee, to come up with any agreement on "closer cooperation" save a decision to continue studying the problems.

47. The Poles have continued to press for agreements on product specialization industry by industry, through ad hoc agreements and through the development of new institutions such as the CEMA organizations for trade in metals (Intermetall) and in chemicals (Interchim), which serve as clearinghouses for orders. Other products suggested for such treatment include electronic and automotive components. But the Poles now realize that progress in this field will come too slowly to mean much in the next five-year plan.

48. Poland is still hopeful of expanding its trade with the industrial West. The Poles expect to increase exports to the area by at least 5-1/2% per year, a rate that appears quite feasible. Agricultural exports, mainly animal products, which

once were the mainstay of Polish exports to the West, will increase little if any. As a result partly of West European protectionist policies and reduced demand, the Poles have decided to try to eliminate imports of grain for hard currency rather than try to expand exports of animal products; a similar goal set in the 1966-70 plan was unattainable. But Poland can count on continued expansion of sales of coal, sulfur, copper, and iron and steel.

49. About one-half of the probable increase in exports to the industrial West -- which are due to increase from $0.78 billion in 1968 to about $1.1 billion in 1975 -- is likely to come just from the expansion of copper and sulfur exports, which are sold mainly (75%) to the industrial West. The rise in these exports represents a payoff on investment projects started not long after the discovery of rich mineral deposits in southwestern Poland in the 1950s. Exports of coal, now the largest earner of hard currency, and of iron and steel products, which come second, will doubtless grow more slowly, but should provide up to one-fourth of the total planned growth. Although overall demand for coal in Western Europe is not likely to grow much, Poland may be able to increase sales to some coal-poor markets (Norway, Italy, and Japan). Sales of iron and steel products, mainly pig iron, ingots, and basic shapes, seem to hold up well, and further increases in Polish exports are possible.

50. The rest of the growth of exports must come from sales of chemicals and of light industry and machinery products. The Poles are especially interested in expanding such "value added intensive" exports. Consumer goods probably have the best prospects, if Poland does not run into serious quota limitations. Textiles, shoes, furniture, ceramics, and glass all offer possibilities of expanding sales, if Poland can judge the market right. Western help in designing and marketing would make a big difference. Chemical exports can undoubtedly be expanded substantially. Exportation of machinery, however, which interests the Poles the most, offers no very promising prospects, for reasons explained earlier. Even with Western help it is doubtful whether Poland will increase significantly the share of machinery in exports to the West.

51. Poland has been trying to muster help in exporting high-grade manufactures in the 1960s in several ways -- by joining the General Agreement on Tariffs and Trade (GATT), by investigating possibilities for new agreements with Western governments, and by upping expenditures on research and development.

52. Poland was able to join GATT in 1967 by offering, in lieu of the tariff liberalization offered by Western countries, the assurance of a minimum 7% increase in imports collectively from GATT members. In return, Poland was hoping for easing or removal of quota restrictions on sales to member countries, especially its most important customers in the Common Market. During the first two years as a member, however, Poland appears to have failed to meet its obligation to increase imports, and the Common Market has failed to offer many concessions to Poland.

53. More promising appears Poland's chances of negotiating substantial help from West European countries in five-year trade agreements, especially guarantees of long-term credits on favorable terms. Poland is proposing in 1971-75 to buy a good deal more machinery in the West. Until now the Poles have followed a rather conservative policy in buying on credit. Hard currency indebtedness probably stands at more than $600 million, but represents only three-fourths of the value of hard currency exports in 1969.* The amount probably will be reduced somewhat in 1970. With the assurance of a steady increase in exports, the Poles can easily raise their indebtedness by several times. But they will probably remain careful; even by 1975, total hard currency indebtedness at most probably will be only about $1.3 billion, not much greater than hard currency earnings. In contrast, both Bulgaria and Romania, the most adventurous East European regimes in the Western market, owed nearly twice the amount of their hard currency earnings in 1968.

* *This estimate excludes very-long-term interest-free indebtedness to the US for deliveries under PL 480, which amounts to little more than $400 million, payable in dollars or, as agreed, in domestic zlotys.*

54. Poland has already negotiated a credit line of $125 million with France for imports of equipment through 1972, repayable in goods, chiefly copper. But the largest share of Polish purchases on credit probably will be supplied (and financed) by West Germany. In the trade negotiations begun in October 1969, the Poles repeated earlier proposals that the West German government guarantee credits running over $100 million a year for the period of the agreement. At present it looks as if the West German government will hold out the prospect of credit guarantees on this scale, but will make commitments only for a year at a time. Even on this basis, Poland would be in a position to do some planning, and -- what is more -- to ask other countries to raise the ante to match the West Germans.

55. If the agreement with West Germany follows these lines, then the Poles probably will be able, as they would like, to buy up to $1.5 billion worth of machinery on credit in the West in 1971-75 and a total of as much as $2.5 billion of machinery to upgrade existing plant and equipment. These purchases would amount to about 30% of total planned machinery imports during the period, a sharp rise above the present share (somewhat more than 20%). In terms of total investment in machinery, however, even imports of $2.5 billion would amount to a small fraction (perhaps 15%) of total machinery invested.

56. [redacted] it 25X1
appears that Poland will be interested especially in machinery that would improve the competitiveness of key exports, especially those that have a good chance of acceptance in the West. This policy should lead to greatly increased interest in equipment for light industry. The Poles probably will also want to add data processing equipment, plant and equipment for the growth industries (chemicals and electronics), transport equipment, and perhaps equipment for rolling high-grade steel.

57. Besides credits and easing of quota restrictions, the Poles are renewing their interest in "joint ventures" for producing and marketing new goods. They were among the first to show some interest in this field, when Krupp's Berthold Beitz was promoting joint ventures in 1965. Since then

they have not made much progress. This year, however, in negotiating a five-year trade agreement with France, the Poles did get a promise of help in producing some manufactures, which will be marketed in France outside of existing import quotas. In approaching the West Germans in the summer of 1969 on the subject of a long-term extension of their trade agreement, the Poles likewise included production assistance as one of their interests. Western know-how in technology, management, and marketing could eventually make a significant contribution, especially in labor-intensive industries, such as the consumer goods industries.

58. Nevertheless, even with good fortune -- the extension of $1.5 billion in Western credits, some cooperation on quota restrictions, and new activity in joint ventures -- the visible effects on production and efficiency would be slight. With better investment control and a high priority for putting Western machinery to work, construction, installation, and the learning process will last well into the period, even for the first imports made in 1970 or 1971. The main addition to Polish capacity will come from projects already begun in the 1960s.

59. The same is surely true of the expansion of research and development. Poland already spends relatively more on research and development than other East European countries -- 2% of the "national income" in 1969. Further increases are to bring the share to 2.5% in 1975. The research effort, as has already happened in other East European countries, is to be tied more directly to production. It is far from clear what a country in Poland's position can best do in research and development. Lack of scientific and even of engineering background, however, is not the key weakness of Polish industry, but rather the know-how that can be acquired only through operating the newest plant and equipment. That is likely to remain one of the bottlenecks in the Polish economy for a long, long time.

Conclusions

60. In 1971-75 Poland will try to modernize selected industries through improved planning and management, closer cooperation with other Communist countries in trade and investment, and large-scale purchases of machinery on credit from the West. The Poles do not expect to have a lot to show for these efforts by 1975. The leadership apparently will be satisfied to maintain economic growth at recent rates, which for GNP averaged 4-1/2% to 5%. This rate implies a somewhat faster rise in overall efficiency in the event -- rather unlikely -- that the growth of employment can be held to planned rates. Living conditions will improve only slowly. A 2% annual rise in personal consumption per capita is projected, mainly in the form of increased use of very high priced items (quality foods, better grade clothing, and consumer durables). Little improvement is to be expected in the per capita availability of housing and other services.

61. The Polish reforms in planning and management affect mainly the State Planning Commission, the economic ministries, and the foreign trade and transport organizations. The leadership has moved in younger, better qualified people, has cut back the effort that the central authorities spend monitoring production, and has reinforced their power to deal with inflationary pressures and to guide investment. Industrial enterprises and associations remain largely under the same managers, and their freedom of action is carefully restricted, even more than before in respect to employment, wages, and investment, although they no longer have to meet obligatory quotas for output in physical units. The reforms, in short, are intended mainly to improve administrative controls. They may well have some effect, especially in reducing inflationary pressures.

62. The prospect of closer economic cooperation with other Communist countries keeps receding. At the 23d General Council of CEMA in April 1969, the Poles pleaded for closer cooperation, through any and all means acceptable to the members. The Poles are convinced that the CEMA countries cannot go on producing more and more machinery and trying to sell

it to one another, without arranging for specialization, cooperative investment projects, and joint research and development. That will come very slowly, as they doubtless realize.

63. The Poles should not find it hard to increase machinery imports from the West. Their exports should continue to rise by at least the planned rate of 5-1/2% per year, largely through expanding sales of raw materials and metals, and their credit is good. West Germany, Poland's second largest trading partner in the West, doubtless will go beyond France's lead in extending credits to Poland if the negotiations begun last fall are concluded successfully. But machinery imports from the West suggested by the foreign trade plan, though fairly sizable, as much as $2.5 billion in 1971-75, will still represent a small share of all Polish investment in machinery and equipment -- an estimated 15% -- and the payoff would come only after several years. Thus it is quite unlikely that the expansion of Polish imports from the West will have much effect on the efficiency of Polish industry and on the competitiveness of Polish exports at least through 1975.