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TRANSFORMATION IN POLAND

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Abstract: The paper analyses transformation process in Poland between 1989 and 2004. The goal of the paper is to clarify the most important steps in the economic policy that were carried out in this period. The structure of the paper follows this general goal. We first of all analyse economic development of the country before the fall of the communist regime because this determined the whole following process. Then we shortly mention political development that had a significant impact on the transformation process, and its results. In the next part we concentrate on the main steps in the economic transformation, and consequently devote place to specific aspects – for example privatisation. The final part analyses the main economic indicators of this period. We conclude that the transformation process achieved its main economic goal and the economy's ability to grow increased.

Key words: Poland, economic transformation, economic growth

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TRANSFORMATION IN POLAND

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The goal of the paper is to analyse economic development in Poland during the transformation period. The paper is organized as follows: first of all, we concentrate on the political development during the communist period in order to understand better the initial political and economic conditions in the country. The same objective is pursued in the second chapter describing the state of the Polish economy at the end of the 1980s. These two chapters should help the reader understand the extent of the goal to transform the economy from a centrally planned one to market system. In the following chapters we briefly describe political development during the transformation period as politics played a crucial role in determining economic measures. And we follow the transformation period up to the admission of the country to the EU in 2004.[2] The main part of the text is dedicated to economic reforms taking place in the country after 1990. Separate subchapters concentrate on privatisation and development of the banking sector. Economic results are analysed in the last chapter. We will see the development of the main economic indicators – among others economic growth, unemployment, inflation and external relationships.

Generally, we proceed in the structure from the situation at the beginning of the transformation process, via the economic policy that was applied by the reformers to the economic results that were achieved during the transformation period. As a consequence, the reader should become familiar with all the main aspects of the economic transformation and economic results.

We would like to point out that while working on the paper, we came across troubles with data. There are foremost problems with the length of consistent data series because it is highly difficult to find relevant and homogenous data that would cover the whole transformation period. As a consequence, we are forced to use shorter series. The data that we use are in our view the best that could have been obtained.

1. Long run political development

Poland became a part of the communist block after the Second World War. But Polish relationship with Russia and the Soviet Union later was always prickly and it determined the attitude towards socialism in the country.[3] The first step on the way to

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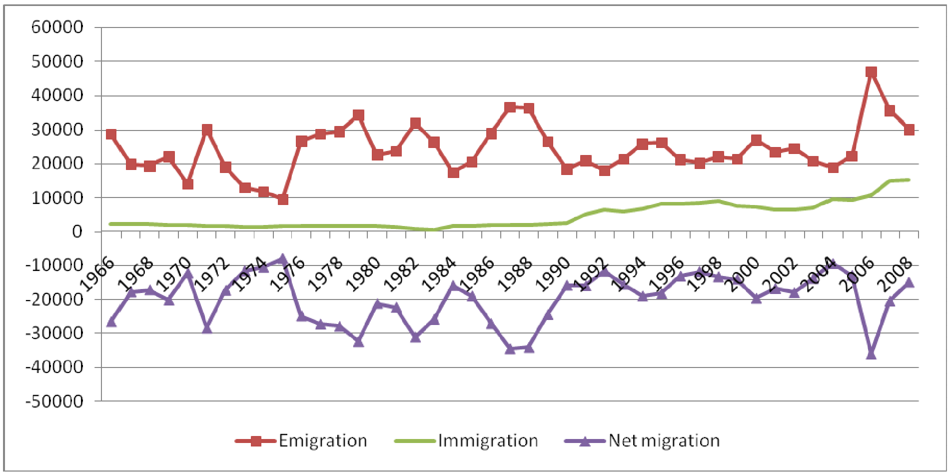
[2] In rare cases (when we found it interesting) longer lines in charts are depicted, or data in tables refer to longer periods. But the text concentrates only on the period up to 2004. When useful we add into the tables information about development in other countries (foremost in the Czech Republic and Hungary). This is only additional information for the reader. In the text we mainly focus on describing the development in Poland.

[3] We can mention several events – occupation of a part of Poland between the end of the 18th century till the First World War; the Polish-Russian War (1919-1921); the Molotov-Ribbentrop pact that divided Poland between Germany and the Soviet Union at the beginning of the Second World War; or the massacre of thousands of Polish officers by Russians troops in Katyn in 1940.

total Russian domination was the fact that the Polish post-war government was created only from the exile government situated in Russia. The exile government in the UK was totally ignored. Later on, Polish communists (Polish Worker's party – PSDS) rigged elections in 1947 and took over the power.

The communist reign was not without problems. The first mass uprisings took place in Poznan already in 1956. The protests were triggered by lack of foodstuff and consumer goods, decline in real incomes and generally bad economic situation. However, these protests were suppressed. In 1956, Wladyslaw Gomulka (1905-1982) became the leader of the PSDS. He proposed a program of economic reforms. The Soviet Union did not agree with the steps and even threatened Poland with a military action. Later on, the situation calmed down and Gomulka proceeded with the reforms and his reign is nicknamed as Gomulka´s thaw. But the economic situation did not improve and there was another wave of riots and strikes in 1970 which were bloodily suppressed and led to Gomulka´s resignation. Eventually, he was replaced by Edward Gierek (1913-2001) in 1970. Gierek promised economic reforms, improvement in industry, and overall uplift of Polish economic situation. Gierek was able to convince western politicians to provide aid and loans to Poland. But the country suffered from growing prices, food shortage and increasing foreign debts. In 1978, Jan Pavel II was elected the new pope; he soon became a symbol of Polish opposition against the communist regime. Generally, lack of basic freedoms and inferior economic conditions were proved in high numbers of people that left Poland during the communist reign as we can see in the following chart. Between 1966 and 1989, nearly 600 000 Polish inhabitants left the country.

Chart 1: Emigration, Immigration and net migration in Poland in 1966-2008



Source: *Central Statistical Office (GUS), http://www.stat.gov.pl/gus/5840_8408_ENG_HTML.htm, (29. 12. 2010)*

The government decided for another round of economic reforms and among others increased prices in 1980. This step led once again to protests. This time, the protests were centred in shipyards in Gdansk and Szcecin, where trade unions named Solidarity were consequently formed. Lech Walesa (1943-) became the leader of the trade unions. During the riots, Gierek was forced to resign.

General Wojciech Jaruzelski (1923-) took power in 1981 after a short reign of Stanislaw Kania. He proclaimed martial law with the main goal to suppress the Solidarity movement. The trade unions moved to illegality and the leaders were put to jail. Walesa won the Nobel Peace Prize in 1983. The conflict between the communist government and the opposition lasted untill the beginning of 1989 when a new surge of huge strikes forced the government to accept Solidarity.

2. Economic situation

The centrally planned system was introduced in Poland after the Second World War. The country was relatively backward with a large part of GDP created in agriculture. The farmers were forced into cooperatives just like in other countries of the Eastern Block. However, a relatively high proportion was allowed to remain in private hands, or returned to private owners already in the 1950s. In comparison to Czechoslovakia, this was a significant and important difference. Economic reforms were applied during the political melting in the 1960s and the 1970s. For example, Poland became a member of GATT in 1967. During the 1970s Polish government borrowed a lot of money from abroad, which led to growing foreign debt. Since 1976 the country offered legal environment for foreign direct investment. Generally, Gierek hoped to increase economic growth by a huge investment wave. During the first half of the 1970s, investment really increased by 133 % and GNP by 29 % (Berend, 2009). However, this development did not lead to improvement in the structure or technological level of the economy – it was directed mostly into the backward industries. As a consequence, investment mostly resulted in overheating of the economy and continuous inflationary pressures.

The economic situation sharply worsened with the start of the global debt crisis in 1980. Poland was one of many affected developing countries at that time. Polish GDP declined by 10% between 1978 and 1983. This economic crisis brought about lack of foodstuff and consumption goods, and led to a wave of riots connected with the founding of Solidarity as we have already mentioned. The government deficit reached 8% of GDP at the end of 1980 (Watanabe, 2002). In 1982, the country was not able to pay its debts. Furthermore, it suffered from the deficit of balance of payment and monetary excess in the following years as well. Foreign debt can be seen in the next table.

Table 1: External debt/exports of goods and services (in %)

	1985	1986	1987	1988	1989	1990
Bulgaria	34.8	52.9	61.3	86.5	106.2	154.6
Czechoslovakia	32.4	33.8	36.2	40.2	45.1	56.3
Hungary	148.5	166	174.9	173.8	169.7	171.7
Poland	252.1	259.5	294.8	254.	261.7	251.5
Rumania	63.5	66.1	57.7	20.3	4.3	6.1

Source: Jonáš (1997)

The martial law did not succeed in stabilizing the economic situation. There was continuous lack of basic products during the 1980s. Economic results were worsening even if there were steps towards economic rationalization – Poland, for example introduced a bankruptcy law in 1983, a two-pier banking system in 1988 and it was possible to start small business for foreigners with Polish roots already in the 1970s. The main reform steps are depicted in the following table.

Table 2: Chronology of reform measures before 1990

Reform measure	Hungary	Poland	Czechoslovakia
Cancellation of obligatory plans	1968	1982	1990
Cancellation of centralized quotas	1968	1991	1990
First steps leading to liberalization of prices	1968	1957,1975	1991
Unified exchange rate[1]	1981	1990	1991
Admission to IMF and WB	1982	1986	1990
Free private enterprises	1982	No restrictions	1991
Bankruptcy law	1986	1983	1991, 1992
Two-stage banking system	1987	1988	1990
New income tax system	1988	1992	1993
VAT system	1988	1993	1991(sic)
Corporate Law	1989	1990	1991
Trade liberalization	1989	1990	1991
Unemployment benefit system	1989	1990	1991

Source: Kornai (1996)

The country was hit by another crisis in 1987 which resulted in growing shortage of foodstuff and consumption goods. The government once again partly liberalized prices, which led to growing inflationary pressures. This indicator reached 640% in the autumn of 1989 (average yearly increase in prices in the 1980s was 60%). On the whole we can say that economic policy in Poland was chaotic. Exchange rate was another example of economic distortions. We can see it in the following table. The difference between the official exchange rate and the exchange rate on the black market was enormous.

Table 3: Exchange rates to American dollar (averages in units of national currency)

	Czechoslovakia		Hungary		Poland	
	Official	Unofficial	Official	Unofficial	Official	Unofficial
1988	14.36	33.44	50	.	431	1979
1989	15.05	43.39	59	.	1446	5665
1990	17.39	(39.0-40.0)	63	.	9500	9570
1991	29.48	32.28	74	.	10559	10731

Source: Winiecki, Regional survey, (1993)

[1] The centrally planned economies used to have systems with multiple exchange rates – for different transactions (for example exports, imports, tourism and so on) different exchange rates were used. Unifying of the exchange rate meant abandoning of this system.

Economic results were partly caused by specific Polish self-managed socialism. This system was generally similar to the system in Yugoslavia. The main idea was that companies controlled by the workers should function in a better way. It was hoped that the motivation of the employees should increase and it should improve overall efficiency. The system was introduced under the pressure by Solidarity in 1981 with a new Act on State Enterprises. According to this act, self-governing councils were established in all companies (with the exception of military and strategic production). The councils were elected by plenary meeting of all employees for 2 year periods. They were enormously powerful – they had rights to appoint and dismiss directors, control their activities, exercise the veto privilege over all important decisions, accept production plans etc. The councils had the right to decide about liquidation of the company as well. In reality, the impact of the system on companies is generally deemed negative. The employees imposed pressure on the management to increase wages in excessive way (that add to inflationary pressures) – Holman (2000). Both of the countries that foremost used this system – Poland and Yugoslavia – suffered from high inflation. The employees were (of course) against any rationalisation of production connected with dismissing of workers. And the system did not improve motivation of the employees either (Holman, 2000).

Overall ownership structure was another problem of the Polish economy. State companies and cooperatives created 81.9% of GDP in 1988 and the private sector made 18.1%, but without agriculture the number was only 7.6% of GDP (Wang Zhen, 1991). The long-run development of the state and private share can be seen in the following table. We should notice that the share of the private sector was growing since the end of the 1970s and that handicraft production, for example, was mostly private (Gabrisch, Hölscher, 2006). Generally, private sector was significantly larger than in Czechoslovakia.

Table 4: The share of nationalized and private sector in industrial production in Poland

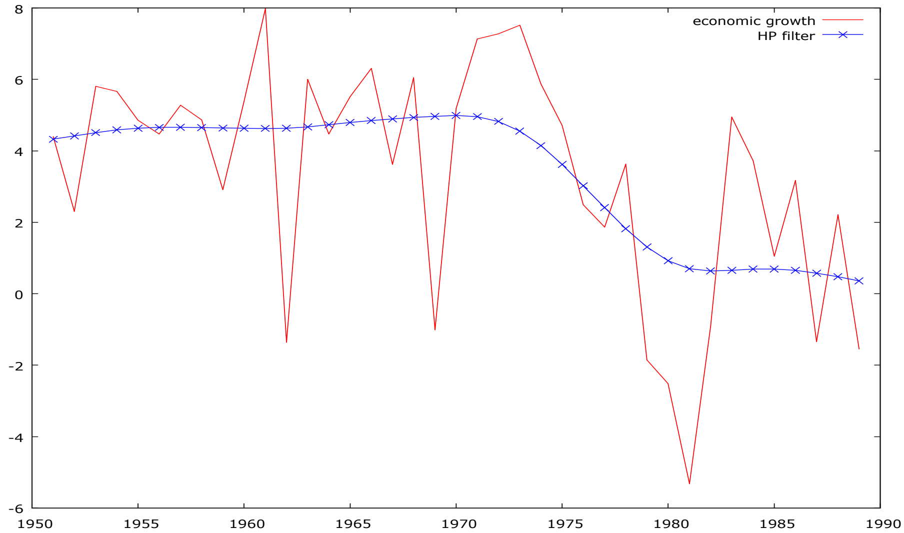
Year	Share of the nationalized sector	Share of private companies
1977	98.22	1.78
1980	97.54	2.46
1985	95.49	4.51
1989	93.4	6.6
1990	91.2	8.8

Source: Wang, Zhen (1991)

The structure of the Polish economy represented yet another problem. The share of agriculture in GDP and employment was very high (see table 18) and thus it was a proof of relative underdevelopment of the economy. Armament production which created a relatively high (2.5%) proportion of Polish industrial production was another obstacle to the transformation process. In the 1980s, Poland was among ten biggest producers of weapons (usually right after Czechoslovakia). Most of the weapons (two thirds) were produced for the Warsaw Pact countries and in the Soviet Union in particular (Szayna, 1995).

There were economic problems already in the 1960s – the following chart shows sharp declines. After the previous analysis of economic policy, we should not be surprised that the long-run economic results extremely worsened in the second half of the 1970s. Economic growth declined to zero and stayed close to it in the following decade (average growth was only 0.35% - Maddison, 2010). We should notice the overall trend in the chart, too.

Chart 2: Economic growth and long run trend (by HP filter) in Poland 1950–1989 (in %)

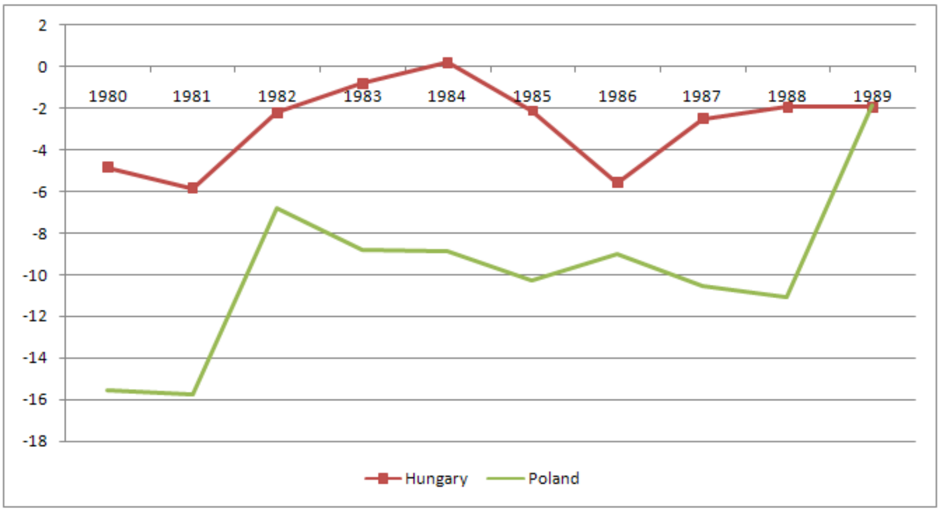


Source: Maddison, Historical Statistics, Retrieved October 11, 2010 from http://www.ggdc.net/MADDISON/oriindex.htm

As we have already mentioned, Poland had problems with inflation pressures in the 1980s. Monetary excess which was connected with financing of the government debt was the main culprit, yet another source can be seen in a continuous pressure on growth in wages which was not balanced by growth in productivity (see above). The government responded by regulating wages and prices. These measures led to general imbalance on the markets; lack of goods and emergence of black market; or see it from a different angle surplus of aggregate demand over supply. Regulated prices meant that part of the inflation pressures stayed suppressed (and appeared only after price liberalization). There were similar problems in other economies (Hungary and Czechoslovakia), too, but in Poland the situation was generally significantly worse.

Another huge problem was connected with current account. We can see the development of this indicator in the following chart. The economy was relatively closed, too – it had a lower volume of trade than Czechoslovakia in 1989 (Lavigne, 1999) even though the size of the economy was of course bigger, and Czechoslovak economy was relatively closed as well. At the same time, foreign investment in the country was highly limited. According to UNCTAD (2006), FDI stocks reached only 0.2% as a percentage of GDP.

Chart 3: Current account balance % of GDP



Source: International Monetary Fund, World Economic Outlook Database, October 2010, http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx (1.12.2010)

We have described economic development in the country. But we have omitted the economic steps that were taken in 1989 after Rakowski government had introduced a reform program. The program included among others liberalisation of foreign exchange transactions; equal conditions for different types of ownership and opened ways for privatisation of state owned companies, it also reduced subsidies on a large number of consumers products (especially food), and closed inefficient plants or incentives for foreign investors (Watanabe, 2002). The author concludes that economic reforms as a consequence did not have to start from the scratch.

3. Political development

We have already mentioned that weak economic situation led to a situation when the communist party was forced to accept negotiations with Solidarity in 1989. The round-table negotiations resulted in a pseudo-democratic system that was expected to last for 4-6 years. Part of the agreement was a promise to organize elections in June 1989. The elections were only partly free, but Solidarity achieved great victory that resulted in a situation when this political force de facto took power. And Poland finally had its first non-communist government in September 1989. Some of the authors – Orenstein (2001) – think that the change was so quick that Solidarity was completely unprepared for it. But the support for the government was very high anyway – 75% – at that time. Walesa was elected the president at the end of the year.

The first entirely free elections took place in 1991. Solidarity had meanwhile split apart. The economic development was one of the causes of the split because there were constant disputes about the radical economic reform. Transformation decline was more severe than had been expected. The proportional electoral system resulted in 29 political parties in the Parliament. No party gained more than 13% of the votes, and so the political situation was fragile and coalition governments (and prime ministers) changed several times and they were generally weak. There were other disputes inside Solidarity, among others about the pace of the economic reforms. The first steps towards European integration were made by signing the associate agreement in 1991. New constitution was approved in 1992 and it codified a more influential role of the president.

Protests took place during the whole period since the start of the reforms but the summer of 1992 was exceptionally “hot”. As a consequence, early elections proceeded in 1993. The elections were won by left wing parties with the Democratic Left Alliance (post-communist party) as the winner. The new government generally continued with the transformation process but at slower pace, and it also put more emphasis on social aspects. The leader of the Democratic Left Alliance Aleksander Kwasniewski (1954-) defeated Lech Walesa in the following presidential elections in 1995 and became the head of the state for the next 10 years.

The next parliamentary elections in 1997 were won by right wing parties unified in the Solidarity Electoral Action. It was a heterogeneous block of 40 political groups. They joined against the left but it was difficult for them to find a uniform position while governing the country. In spite of this, the government was able to take unpopular steps leading to decline of its popularity and its collapse in 2000. In the meantime, Poland became a member of NATO in 1999. The country was run by a minority government untill the next elections in 2001. These were won by landslide by the Democratic Left Alliance again. The party created a coalition together with the Polish People’s Party. But this coalition broke down in 2003 and the country was ruled till the next elections by a semi-clerical government. Poland became a member of the EU in 2004.

Facts mentioned above show that political situation in Poland was rather unstable. The governments changed quickly (there were 10 prime ministers in Poland between 1990 and 2004) and they were often not able to survive even one election period regardless of positive or negative economic results.

4. Basis of economic transformation

The country was affected by the same discussions about the overall directing of the economic transformation as other countries. The opinions varied from gradualist to shock therapists. The difference was in Polish economic situation at that time that was much worse than in Hungary or Czechoslovakia. The economic situation was in fact close to being catastrophic – hyperinflation, budget deficit, huge foreign debt, large money excess and deficit of the current account. The situation was critical and Polish economists recognised it as such. It is not surprising that they decided to solve this situation by quick and deep measures – in other words by a shock therapy or “Big Bang” reform.

The mood in the country was generally in favour of a change and towards a market economy but the view can be different if we consider specific attitudes of the inhabitants. The results of a broad public opinion survey can be seen in the following table. We can notice that the attitudes in Poland (as well as in other countries) can be described as socialist or at minimum left wing. We can attribute this to general lack of knowledge about the function of market economies because it seems that people desired the best from both of the systems. There were high expectations connected with the introduction of market economy that most of the peopled deemed to be the best. But at the same time, the very same people though that governments should maintain a leading role in the society and preserve the advantages of the former system.

Table 5: Percentage of people that deemed the topic as highly important or important (survey carried out between November 1990 and August 1991)

	Hungary	Poland	Czechoslovakia
Who should cover medical expenses			
Treated persons	14	27	18
Government	86	61	82
It is necessary to restrict personal earnings			
No	41	82	80
Yes	59	15	20
Do you deem differences among the rich and the poor asan important problem?	64	64	70
Do you think that capitalist economy based on free initiative is the best for your country?	71	78	67
Do you consider the following to be the government's task (answers yes and probably yes)			
Find everybody a job	71	62	57
Carry medical costs of the ill	87	66	78
Secure living standards for old people	90	65	80
Reduce differences among incomes of rich and poor people	57	26	40

Source: Kende (1993)

Balcerowicz plan and following development

The shock therapy plan in Poland is connected with the name of Leszek Balcerowicz (1947-), who was the Minister of Finance in the first Solidarity government.[1] We should stress that the reformers tried to stay out of politics (and remain just technocrats) at that time but they depended on the support of politicians (Orenstein, 2001). Another important person for Polish transformation is Jeffrey Sachs (1954-) who was then the key economic adviser of the Polish government.

Poland started its reforms as the first country of the Eastern block already at the beginning of 1990 (its progress had as a consequence an impact on the transformation process in Czechoslovakia for example). The reformers decided to shift the economy into market environment by liberalization and parallel stabilization as soon as possible. The reform program contained immediate liberalization of markets (including price liberalization) and inner convertibility of the zloty. The convertibility was broader than in Czechoslovakia because the market agents were able to have accounts in dollars and later on (since the June of 1991) it was possible to repatriate wages and profits (Winiecki, 1993). The currency was deeply devaluated (43%) and fixed to the dollar. It was expected that the central bank would be able to keep this exchange rate only for 3-4

[1] He was ministry of finance untill the end of 1991 and then again in years 1997-2000. He held the position of the President of the National bank of Poland between 2001 and 2007.

months (Nuti, 2000). The Polish government received USD 1 billion in the form of a stabilization fund from G-24 and bridging loan from the Bank for International Settlements (USD 215 million). The purpose of this capital was to support trust in the currency. The load did not have to be used.

At the same time the government tried to restrain growth of wages – increase above set limit was heavily taxed (called a popular way POPIWEK). In specific, the tax on income ranged from 200% to 500% in case that growth of wages overcame predetermined indexation coefficient linked to inflation (Watanabe, 2002). But the tripartite was able to increase wages later on.

The Cabinet tried to apply fiscal restrictions too – the intention was to diminish the government deficit from the previous year. The main way to achieve this task was via limiting subventions (Watanabe, 2002). The sharp decline in subsidies can be seen in the following table. Privatisation was not part of the first reform package and was planned to start later on.[1] All over it was probably the toughest shock therapy in the whole Eastern block (Holman, 2000). Nevertheless, inflation pressure was high as a consequence of dismantling of the capital excess.

Table 6: Change in relative size of subsidies (measured in per cent of GDP)

	1988	1989	1990	1991
Czechoslovakia	13.0	16.0	12.1	7.0
Hungary	13.4	9.1	8.4	6.0
Poland	13.5	9.6	6.7	2.4

Source: Winiecki (1993)

The country suffered from transformation recession as well but there was not a single case of bankruptcy. Nominal wages increased but the wage regulation helped to keep real wages low – the overall decline of real wages reached 30% (Watanabe, 2002). Growth of unemployment was another problem – it sharply and quickly increased from 0.1% in 1989 to 6% at the end of 1990, and 11.8% in 1991. It meant nearly 100 000 newly unemployed people every month. Support for Solidarity declined to 55% already in the middle of 1990 (Orenstein, 2001). On the other hand, the government was able to keep the public finance in surplus in 1990.

Development of the main economic indicators can be seen in the following table.

Table 7: Development of the main economic indicators in Poland 1990-1993

	1990	1991	1992	1993
Real GDP	-11.6	-7	2.6	3.8
Inflation (CPI)	585.8	59.4	45.3	36.9
Unemployment	6.5	11.8	13.6	16.4
Public budgets (% of GDP)	0.7	-6.4	-6	-2.8

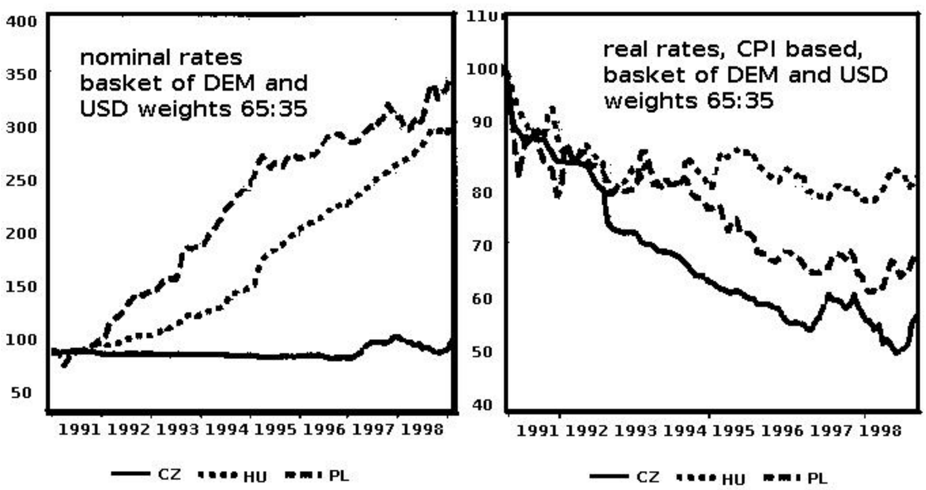
Source: Holman (2000)

[1] According to Duvivier (1997) the reason was that the reformers were preoccupied with stabilisation of the economy.

There were foreign causes of Polish economic troubles as well; and disintegration of Eastern markets was to be blamed. International trade with the Soviet Union declined by 90% between 1990 and 1991 (Bienkowski, 1995) – only several years before the country had purchased between 30 and 40% of Polish exports. Decline in trade with the Soviet Union was a symptom of general decline of trade with the COMECOM countries. And export of weapons, for example, slumped to 5% of the state in 1987 (Szayna, 1995)! On the other hand, Poland received a huge support from Western countries. This support started already in the autumn of 1989 when PHARE (Poland and Hungary Aid for Economic Restructuring) was created. Later on (in April of 1991) 50% of Polish debts were remitted; the USA for example wrote off 70% of the Polish debt and the rest in 1993 (Berend, 2009). The IMF helped to create a stabilization program and lent Poland money (Berend, 2009). On the other hand, the relationship was not always rosy because Poland exceeded limit for deficit of the public finance in 1991 and the Fund suspended Stand by credit. Monetary policy was restrictive in the first years of the transformation, too, and not surprisingly used mostly administrative instruments – credit ceilings and reserve requirement.

In the end, the central bank was able to defend the exchange rate untill May of 1991 in spite of the growing deficit of the current account going on from the last quarter of 1990. The zloty was in May devaluated by 17% and it was fixed to a basket of five currencies instead of the US dollar only (45% USD, 35% DEM, 10% GBP; 5% FRF; 5% CHF). In October the exchange rate system was changed to crawling peg (1.8% per month) with narrow band (+/- 1%). There were bigger devaluations in 1992 and 1993 (12% and 8%). The cause was the real appreciation of the currency – in other words the exchange rate pillow always quickly disappeared due to relatively high inflation in the country. Later on, the periodic monthly devaluations declined to 1.2% in 1995. As we can see in the following chart, the crawling peg helped to stabilize the real exchange rate in the first years of the transformation but created inflation at the same time.

Chart 4: Nominal and real exchange rate in Central Europe



Source: Frait, Kotlán (2000)

Economic conditions in 1993 were not very good – there was still inflation of 37%, 16.5% of the labour force was jobless and there were deficits of public finance and of the current account. The radical economic reform and its impact shaped the public opinion, and as a consequence, the post-communist left wing party won the elections in 1993, as we already mentioned. The new government came with a program called Strategy for Poland. Its author was Grzegorz Kolodko (1949-), the then Ministry of Finance. The program generally kept the main direction of the transformation process but put more emphasis on social aspects. The government supported a higher role of the state and negotiations with pressure groups – foremost trade unions. The goal was to achieve economic growth and improvements in living standards. We can see in the following table that the program did not have any impact on inequality in the society. Gini coefficient stayed relatively stable after a sharp rise at the beginning of the transformation process.

Table 8: Development of Gini coefficient 1994-2004

	Czech Republic	Hungary	Poland
1989	19.3	21.3	25.0
1990	19.7		26.8
1991		20.3	23.2
1992	20.3		24.0
1993	21.5	22.6	31.5
1994	22.0	23.0	32.6
1995	21.5	24.3	32.2
1996	22.9	24.4	32.9
1997	22.6	24.5	34.0
1998	22.6	24.3	32.6
1999	23.8	23.7	33.1
2000	23.8	25.0	34.2
2001	22.8	25.7	34.0
2002	23.2	24.6	34.9
2003	22.8	25.2	35.2
2004	23.5	27.4	36.6

Note: The coefficient ranges between 0 and 100 with higher numbers means higher inequality.
Source: United nations university - UNU Wider - world institute for Development Economics Research, http://www.wider.unu.edu/research/Database/en_GB/wiid, 22. 12. 2010

Relatively high economic growth helped the government keep budget deficit under control, as we can see in the following table. Monetary policy increased the role of the market instruments after 1993 with targeting money in circulation. This policy came under pressure with massive capital inflows after 1995.

Table 9: General government balance as % of GDP (1990-2000)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Average
Czech Rep.	-0.2	-1.9	-3.1	2.6	-1.2	-1.1	-3.3	-3.8	-5.0	-3.7	-3.7	-2.2
Hungary	0.0	-2.9	-6.1	-6.0	-7.5	-6.7	-5.0	-5.9	-8.0	-5.5	-3.0	-5.1
Poland	3.1	-2.3	-5.3	-2.8	-2.8	-3.1	-3.3	-4.6	-4.3	-1.8	-3.0	-2.7

Source: EBRD: Selected economic indicators data, 26. 11. 2007.

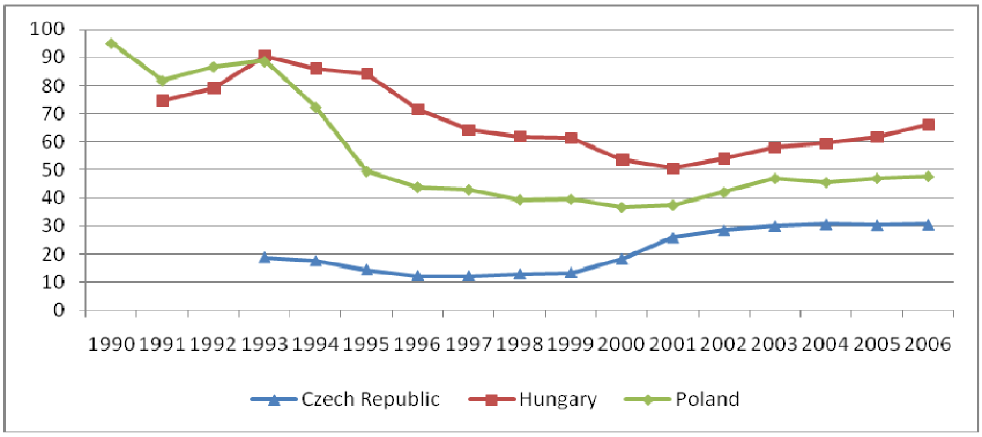
In 1994 Poland made agreement with the Paris and the London creditors clubs. These agreements led to normalization of relationship with the world financial markets after a fifteen-year long pause. In January of 1995, the zloty was re-denominated as a consequence of previous high inflation. The currency was got rid of four zeros – it means 10 000 old zloty (PLZ) was exchanged for 1 new zloty (PLN). Poland liberalized transactions on the financial account (the currency became fully convertible) and the country became a member of the OECD in 1996. The central bank decided to increase the fluctuation zone of the zloty up to +/-7% in May 1995. Liberalization of capital movement led to strong inflow of capital into the country and appreciation pressures. The central bank responded with interventions on the exchange rate markets and purchasing of foreign currencies. In December the Zloty was appreciated by 6%. Foreign reserves increased from USD 5.8 billion to USD 15 billions during the year as a consequence of the efforts of central bank to keep the exchange rate. In the following years, periodic devaluation of the crawling peg system diminished, the fluctuation zone widened to +/- 15 in 1999, and the basket was limited to just 2 currencies in the same year (45 %USD and 55 %EUR)-(Watanabe, 2002).

The economic development in the first half of the 1990s was characterized by decline of the government role. The share of government expenditures in GDP went down from 72% in 1989 to 45% in 1995 (Tomšík, 1996). The government decided for another reform package in 1996. It was named Package 2000. The main goal of the reform package was to improve public finances, achieve decline in inflation and unemployment. Change of the tax system was the main tool. The government made changes in healthcare, education and pension systems after 1997 as well (Orenstein, 2001). The principal reform took place in the pensionary system in 1999. The principal characteristic of the system is that there are 3 pillars – the first is based on pay as you go but with individual accounts in management of a public institution. The second is in the form of private funds - 40% of the levy goes into these funds. And the third is voluntary. The pension fully depends on the size of the insurance.

The economy started to have problems with outer balance. It suffered from a relatively high trade deficit in the last years of the 20th century. And there was undoubtedly negative impact of the currency crisis in Russia in 1998.

The government generally applied restrictive fiscal policy in the following years. It helped to decline public debt as can we see in the following table. We should notice that smilarly to Hungary, Poland improved their public finance after 1993, and in both of these countries public debt was declining till the beginning of the new century.

Chart 5: Public debt, % GDP



Source: EBRD: Selected economic indicators data, 26. 11. 2007.

There were more changes in economic policy around the turn of the century. In 1999, the central bank decided for direct inflation targeting. The Monetary Policy Council defined the inflation target and then adjusted the national bank basic interest rates. The central bank had problems to achieve the goals in the first years, as we can see in the subsequent chart. Since the beginning of 2004, the National Bank of Poland has pursued a continuous inflation target at the level of 2.5% with a permissible fluctuation band of +/- 1 percentage point. Since April of 2000 the zloty exchange rate has been in the system of free floating and it has not been not subject to any restrictions till today.

Chart 6: Inflation and inflation targeting in Poland 1998-2003

Source: NEWTON: Makroekonomický vývoj Polska, 2003

Positive trends in the fiscal sphere were reversed after 2000. The Polish governments had growing problems with fiscal discipline which led to growth in government debt (previous chart). The problems had structural character, as we can see in the following table.

Table 10: General government balance and government structural balance 1998-2005 (in % of GDP)

	1998	1999	2000	2001	2002	2003	2004	2005
Government balance	-3.2	-3.3	-3.3	-5.2	-6.1	-5.6	-5.9	-3.9
Structural balance	-4.4	-4.4	-4.1	-4.8	-4.7	-4.5	-5.2	-4.0

Source: IMF: Republic of Poland: 2003; IMF: Republic of Poland: 2006

In 2004, the country became a member of the EU.

5. Privatisation

If we compare privatisation process in Poland and other Eastern European economies, we can find both similarities and differences. First of all, the country suffered from the same lack of savings as the other countries of the Eastern block (Zielinski, 1993). This characteristics determined the privatisation process because all domestic savings would cover only 15% of the state company's value in 1990 (Commander and col., 1995). But other aspects of the Polish situation were different. We should foremost bear in mind the position of employees and the trade unions in the companies. The employee's councils had in reality the veto right over the privatisation process (Earle, Estrin, 1996). As a consequence, there was support for employee ownership of the companies as the way of privatisation. Lewandowski (1997) writes that in a survey from the beginning of the 1990s, as many as 47% of its respondents preferred this form of ownership.

The first period of privatisation is often referred to as "wild"; "rough" or "spontaneous" (Lavigne, 1999; Gabrisch, Hölscher, 1996). It was made possible by laws approved at the end of the communist period. The decisions about selling or renting of a company were, at that time, in the hands of the management, leaders of the trade unions and the chairmen of the employee's councils. Companies were privatised into hands of employees and respective managers. In other cases, new owners recruited from cousins, relatives or acquaintances of the firm's former management who were often linked with the previous regime (Bienkowski, 1995). Assets were often sold for undervalued prices.

Later on, the government created legal environment for privatisation. In Poland the first (temporary) privatisation law in Eastern Europe was enacted already in the middle of 1990. Disputes between proponents of employee ownership and advocates of classical privatisation resulted in a compromise – employees were able to gain 20% of the company for 50% of the established price (Lewandowski, 1997). A new privatisation law was passed in 1991.

During the first two years of the reforms the government of Solidarity approved two new forms of ownership change. Commercialisation was the first of the two – it meant that a company was transformed into a joint-stock company owned by the Ministry of Finance and prepared for consequent sale. There were approximately 100 companies of this type, each valued higher than USD 15 million (Bienkowski, 1995). Liquidation was the second way. Nestor and Thomas (1995) write that it was a procedure when creditors holding more than 50% of the debt of the non-solvent company were appointed responsible for re-organization or winding-up of the company. The old company was liquidated and parts or all of the assets were sold, rented or transferred into a new company. This was the case of 5500 small and middle companies of a value up to one million dollars (Bienkowski, 1995). The new owners were mostly insiders – usually the management and employees, and it often meant de facto legalization of the previous spontaneous privatisation (Lavigne, 1999). A significant role of privatisation into the hands of employees or the management can be seen in the following table.

Table 11: Employee Ownership Resulting from Privatisation in 1994 (rough estimates)

Country/base group of co´s. for estimation	Companies with employee control	Privatisations (percentage)	Average % held by all employees	Estimated total employment in EOs
Czech Republic (voucher priv., 1st wave)	3	1	4.4	N.A.
Hungary (self-privatisation)	187	43	42.0	36 000
Poland (priv. liquidation)	1 478	75	50.8	450 000

Source: Earle, Estrin (1996)

Meanwhile, small privatisation proceeded and 60 000 shops were sold or leased after dismissing of cooperatives at the beginning of the transformation (Commander, Coricelli, Stähr, 1995). Winiecki (1993) writes that it was a relatively quick process and by the end of 1991 three quarters of shops and restaurants were privatised, although only 1-2 % of them were sold, while the rest was leased. On the other hand, restitutions moved ahead only slowly and unwillingly. And there was a negative attitude towards foreign capital as well – it is not surprising if we realise that Poland had been under foreign control for nearly 150 years. Berend (2009) evaluates the first years of Polish privatisation claiming that the process was generally affected by lack of capital and that it was extremely slow – at the end of the third year (probably 1992) only 26 of the large companies and altogether only 556 companies out of 7000 were sold. At the end of the fifth year just 13 % of state companies were privatised.

Polish politicians decided for a specific form of a voucher privatisation in the middle of the first transformation decade as well.[1] However, only 400 companies (later on 512) took part in this program. The whole concept was different from the Czech one. Large companies became parts of holdings that were governed by national privatisation funds (NIF) with participation of foreign experts. There were 20 (later on 15) of these funds. The NIFs were supposed to conduct the restructuring of the companies. The inhabitants were allowed to purchase shares of these privatisation funds. Each of the funds was mainly involved in approximatelly 30 companies (out of 512) and got 33 % of the shares. Otherwise, the fund gained around 2 % of shares in the rest of the companies. The process was generally very slow. The setting of the funds was delayed because of political disputes till 1996. But this way of privatisation was highly popular and 27.4

[1] Lewandowski (1997) writes that idea of a voucher privatisation originated in mid 1988 and was raised by market orientated economists connected with Solidarity. The voucher privatisation proposal was introduced already in 1991 but the real application started only in 1995.

millions of adult Poles (95 % of the eligible population) participated and purchased the certificates for 20 Zloty (USD 8) – (Lewandowski, 1997). The inhabitants received tradable certificates that were exchangeable for shares of the NIFs. There was an obstacle in the functioning of the NIFs, because it was difficult to lure foreign experts into Eastern Europe and later on disagreements between foreign consultants and domestic managers appeared (Lavigne, 1999).

The process of privatisation proceeded, albeit at a relatively slow pace in comparison to Hungary. We can see the percentage of employees in private sector in the following table. And it became unpopular similarly to other countries. A survey in 2001 showed that 87 % of the inhabitants wanted to keep large companies in state hands. In 2009 the government still wanted to privatise at minimum 800 companies including power stations and coal mines. The overall state ownership covered at minimum 1500 small companies as well (Junek, 2009).

Table 12: Private sector share in employment (in %)

	1990	1991	1992	1993	1994	1995	1996	1997
Poland	47.9	50.0	54.0	57.0	59.0	61.4	61.6	62.0
Hungary	na	na	81.4	78.1	77.6	77.7	78.7	79.2
Czech Republic	7.0	18.7	31.1	47.1	53.0	57.2	58.9	59.7

	1998	1999	2000	2001	2002	2003	2004
Poland	62.3	63.7	65.8	67.9	66.8	68.5	70.6
Hungary	79.5	80.0	80.4	79.6	79.3	79.1	79.1
Czech Republic	60.6	65.0	65.0	70.0	70.0	70.0	70.0

Source: EBRD: Selected economic indicators data, 26. 11. 2007.

6. Development of the banking sector and the stock exchange

Changes in the banking sector began already in 1988 after the government had created nine state banks and divided among them both good and bad credits of the National Bank of Poland. However, this change did not represent the real shift from the previous policy because managers in state banks kept providing state companies with additional credits without any reasonable consideration about repayments (Weill, 2003). The transformation recession in 1990 and 1991 worsened the position of banks and the share of classified credits increased to 36.5% in 1993 (EBRD, 26. 11. 2007). Zielinski (1993) writes that state banks preferred state companies even if they were not solvent.

The government launched a program of recovering of the banking sector – Enterprise and Bank Restructuring Program in 1993. The main method was re-capitalization under the condition that the banks would proceed with solving the problem of classified credits by the end of 1994. The banks were supposed to deal with their problematic clients. The results of the program were deemed to be positive because the share of bad credits declined to 15% in 1996 (EBRD, 26. 11. 2007). Meanwhile, the government started a program of bank privatisation.

Banks gradually evolved after 1995 and started to provide consumption credits and hire purchase. Privatisation of banks was planned to be finished by 1996 but at the end of the following year only four of the heirs of the previous central bank were sold. On the other hand, the share of foreign banks in the overall banks assets gradually increased to 50% as of the end of the 1990s (EBRD, 26. 11. 2007).

Poland suffered from a relatively high percentage of non performing loans for a long time. The percentage of bad loans again increased in the new century, as we can see in the table in appendix. This development can be attributed to a relatively important role played by Polish state banks in the transformation period. In spite of this, the overall costs of cleaning of the banking sector were calculated relatively low in comparison to other countries. Marton and McCarthy (2008) estimated them as 6% of GDP, compared to 10% in Hungary, 14% in Slovakia and 15% in the Czech Republic.

At the same time we should notice that Polish commercial banks played a relatively limited role in the economy. We can see (in the subsequent table) that they provided a relatively limited amount of loans to the economy especially in comparison to the old European countries in 2002.

Table 13: Financial sectors in European countries in 2002

Country	Banking assets (% of GDP)	Domestic credit ('% of GDP)	Stock market capitalization (% of GDP)
Czech Republic	126	61	16
Hungary	61	42	19
Poland	66	39	14
Euro area	265	135	72

Source: Gabrisch, Hölscher (2006)

Stock exchange generally provides another source of capital for expanding business. The size of the stock exchanges in the post-communist countries is small. However, the Polish stock exchange is deemed to be one of the most successful in the whole Eastern block. It was re-established already in 1991. In the following years, shares from the privatisation process appeared on the floor and the number of trading assets gradually increased. Environment that mobilized investors into perspective projects was created. Numbers of Initial public offerings (IPO) in the Central European stock exchanges are shown in the subsequent table. The Polish stock exchange was in this measure by far the most successful among the transforming countries.

Table 14: Number of IPOs in Central Europe

	2000	2001	2002	2003	2004
Poland	11	6	2	2	31
Czech Republic	0	0	0	0	1
Hungary	0	0	0	1	1

Source: Kovanda (2005)

However, the picture is different if we take into consideration stock market capitalisation. This volume was not bigger than in other post-communist countries and lagged behind the average in the Euro area in 2002 (see Table 13).

7. Economic results

We will analyse development of the main economic indicators on the following pages. We concentrate first of all on economic growth, indicators connected with GDP and changes in the structure of the economy. Then we turn our attention towards unemployment and inflation. The last subchapter is devoted to international connections of the Polish economy.

Economic growth

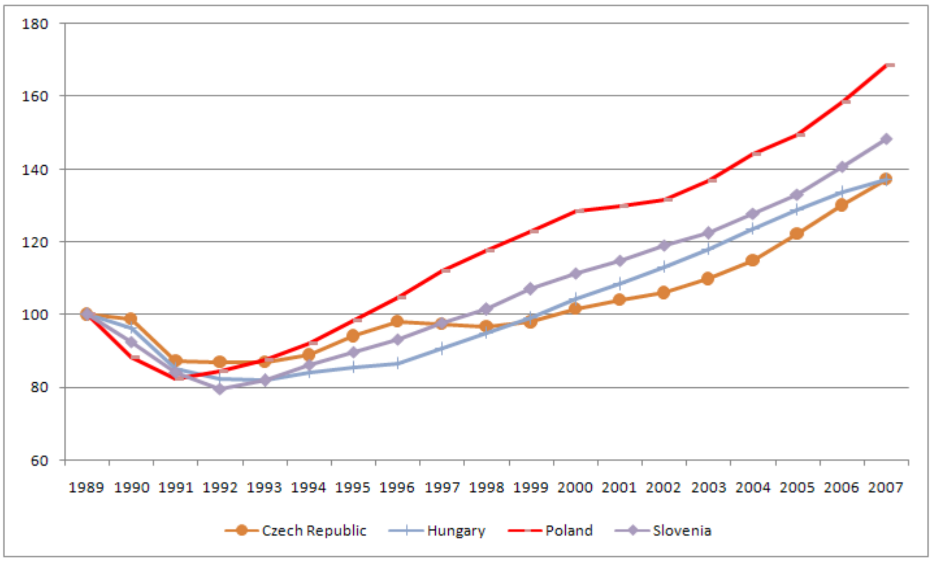
Polish economy suffered from transformation decline at the beginning of the 1990s as well as other economies in the region. The difference was that the Polish economic decline started earlier due to the earlier start of the transformation process. The cumulative slump reached 17.8% of GDP (EBRD, 26. 11. 2007) and it was one of the smallest among the transforming countries (see the following chart). The impact on the respective sectors was possibly worse. Orenstein (2001) writes that industrial production declined by 40% and the production of the building sector by 25%. Holman (2000) notes that the Polish economy was at the beginning of the transformation process on the contrary to other countries bellow its potential level. It means that the starting position was unequal and thus the results were incomparable. Jonas (2000) simultaneously argues that Poland started its reform de facto already in the 1980s. We finds the causes of the slump in decline in domestic as well as foreign demand. In the former, it can be the decline in real wages that plummeted by nearly 30% in 1990 only (Winiecki, 1993). Plunge of exports to the ex-COMECOM countries (see the following subchapter) was among the external causes deeply affecting Polish economy.

Economic growth resurged already after 1992. Poland became the first country of the Eastern Block that achieved the pre-crisis level of GDP in 1996, as we can see in the following chart. At the end of the first transformation decade, only Poland and Slovenia achieved this level. However, we should bear in mind that Poland had an advantage in the low basic level and the fact that the state of the economy was below its potential at the end of the 1980s. Consequently, economic growth was easier and the economy was able to revive without additional investments.

Economic conditions started to improve and strong economic growth was achieved in the middle of the 1990s. We can see the basic development in the following chart. However, the trend is the most important figure in the chart. We should compare it to the development during the communist reign. Obviously, the period following 1990 is marked by a radical improvement. The country was hardly able to achieve positive growth in the 1980s, and inevitably, it was lagging behind the developed countries. In the 1990s after overcoming the transformation slump, the economy got into a phase of continuous growth with just a temporary slowdown at the beginning of the new century.[1] The trend of economic growth improved and at the moment, the economy is able to catch up with developed countries.

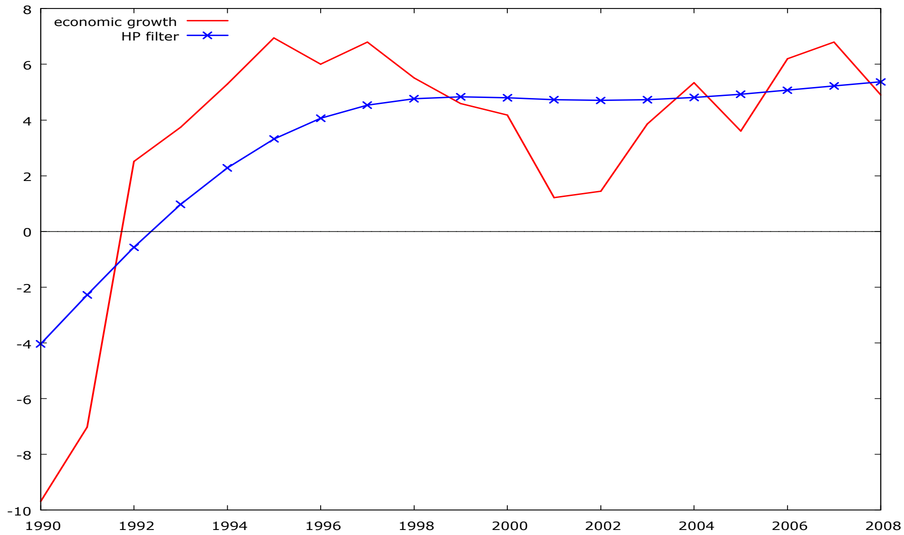
[1] The Polish economy recorded growth even during the last global recession.

Chart 7: Cumulated GDP (1989=100)



Source: EBRD: Selected economic indicators data, 26. 11. 2007.

Chart 8: Economic growth and long run trend (by HP filter) in Poland 1990-2008 (in %)



Source: Maddison, Historical Statistics, Retrieved October 11, 2010 from http://www.ggdc.net/MADDISON/oriindex.htm

Economic development had a straight impact on real wages, which suffered from the transformation recession at the beginning of the 1990s and simultaneously declined. It led to creation of the same transformation pillow (or buffer) as in the Czech Republic. Consequently, high economic growth resulted in an increase in real wages and according to some authors (Jirova, 2001), Poland and Hungary achieved the pre-crisis level already in 1993 (compared to the estimated 89% in the Czech Republic). However, information about real wages notoriously varies and for example Jonas (1997) writes that no country achieved the 1989 level prior to 1995. Another analysis is provided by Klaus and Tomsik (2007). We can see their results in the following table.[1]

Table 15: Real wages in Eastern Europe, the bottom and situation in 2005 in comparison to the pre-transformation year

Country	Year, when real wages reached the bottom	Cumulated growth of real wages against the bottom till 2005 (in %)	Cumulated change of real wages in 2005 against the pre-transformation year (in %)
Czech Republic	1991	98	38
Hungary	1996	57	19
Poland	1993	43	2

Source: Klaus, Tomsik (2007)

General development of the country can be analysed by broader measures as well. One of them is the Human Development Index, published by the UNDP.[2] The following table shows the development of the indicator. We should notice that the index for Poland has significantly improved since the start of the transformation process.

Table 16: Development of HDI in central Europe 1975-2010

Country	1980	1990	2000	2005	2010	HDI Rank
Czech Republic	..	..	0.801	0.838	0.841	28
Hungary	0.689	0.692	0.767	0.798	0.805	36
Poland	..	0.683	0.753	0.775	0.795	41
World Average	0.561	0.602	0.638	0.658	0.678	

Source: UNDP: International human development indicators Retrieved December 22, 2010 from http://hdrstats.undp.org/en/indicators/49806.html

Our picture of the development in the Central European economies can be enlarged by an estimation of the size of shadow economies depicted in the following table. We should remember that there are notorious problems with the estimation of the shadow economy, its definitions diverge, and that all problems connected with measuring shadow economy are multiplied in the transformation process (see for example Hanousek, Palda, 2006).

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[1] The differences among the authors could be caused by discrepancies in defining the “pre-transformation” or “pre-crisis” level.

[2] The Human development index sums up GDP per person, literacy and life expectancy.

Table 17: The size of the shadow economy (in % of official GDP) using DYMIMIC and currency demand method in 1999/2000

Country	Shadow economy (in % of off. GDP)
Czech Republic	19.1
Hungary	25.1
Poland	27.6
Bulgaria	36.9
Austria	14.3
Greece	28.7

Source: Schneider (2005)

Structure of the economy

The whole economy changed significantly during the transformation. We can demonstrate it in the next table showing changes in the structure of employment. There was a general shift from agriculture and industry to services in the Polish economy. The changes were partly caused by a decline in production. Berend (2009) writes that there was a dramatic slump in production of several commodities – for example in production of steel declined from 20 million tons at the end of the 1980s to 8.4 million in 2004, production of coal slumped in the same period from 193 to 101 million tons. Nevertheless, the sector of services grew at the same time.

Table 18: Employment by sectors (% of total employment)

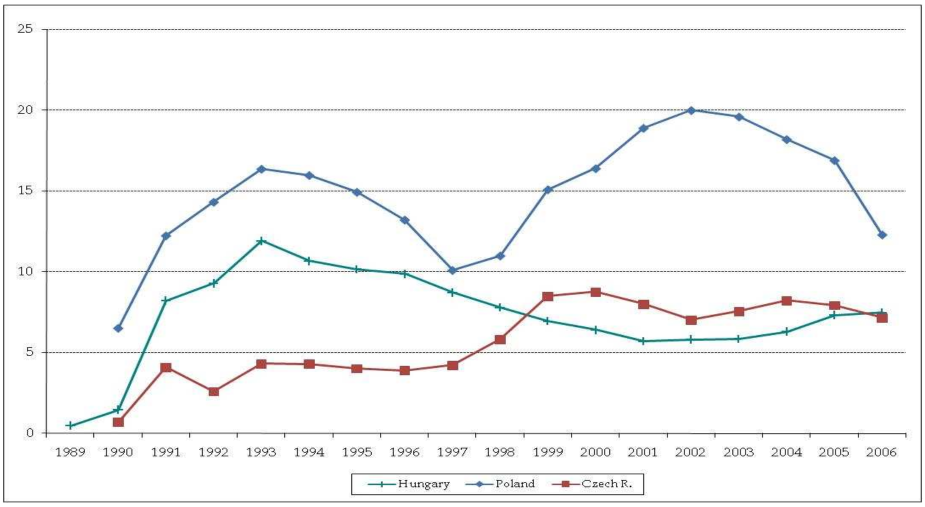
	Czech Republic			Hungary			Poland		
	Agri culture	Indus try	Ser vices	Agri culture	Indus try	Ser vices	Agri culture	Indus try	Servi ces
1990	n.a.	n.a.	n.a.	18.2	36.8	45	25.2	37	35.8
1991	n.a.	n.a.	n.a.	16.1	36.1	47.8	25.4	36	38
1992	n.a.	n.a.	n.a.	11.3	35.1	53.4	25	34.6	39.8
1993	7.7	42.9	49.3	9.1	33.8	56.9	n.a.	n.a.	n.a.
1994	6.9	42.2	50.9	8.7	33	58.1	24	31.9	43.9
1995	6.6	41.8	51.5	8	32.6	59.3	22.6	32	45.3
1996	6.1	41.5	52.3	8.3	32.6	59	22.1	31.7	46.2
1997	5.8	41.1	53	7.9	33.1	58.9	20.5	31.9	47.6
1998	5.5	41	53.5	7.5	34.2	58.2	19.2	32.1	48.7
1999	5.2	40.1	54.6	7.1	34	58.9	18.1	31.3	50.6
2000	5.1	39.5	55.3	6.5	33.7	59.7	18.8	30.8	50.4
2001	4.8	40	55.1	6.2	34.2	59.5	19.1	30.5	50.4
2002	4.8	39.6	55.5	6.2	34.1	59.6	19.3	28.6	52
2003	4.5	39.4	56.1	5.5	33.3	61.2	18.4	28.6	53
2004	4.3	39.2	56.5	5.3	32.8	61.9	18	28.8	53.2
Change 2004/ 1990	-3.4	-3.7	7.2	-12.9	-4	16.9	-7.2	-8.2	17.4

Source: World Databank - World Development Indicators (WDI) & Global Development Finance (GDF); Retrieved December 10, 2010 from http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2

Unemployment

Poland suffered from quick growth in the number of people without a job at the beginning of the transformation process. The unemployment rate jumped to relatively high values already in 1990, and in 1993, more than 15% of the labour force were without a job. Situation on the labour market improved in the second half of the 1990s but again worsened at the beginning of the new century when unemployment reached 20%. We can see the development of the indicator in the following chart. Average unemployment reached nearly 15% of the labour force between 1990 and 2004 (EBRD, 26. 11. 2007).

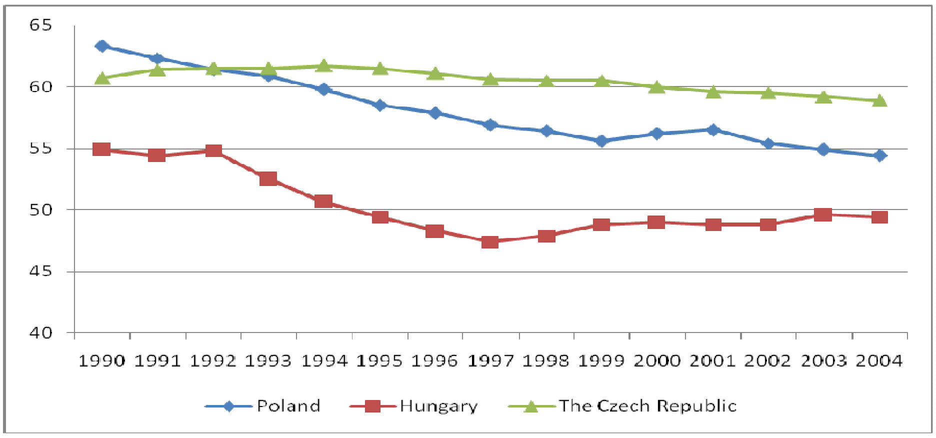
Chart 9: Development of unemployment in Poland, Hungary and the Czech Republic between 1990 and 2006 (in %)



Source: EBRD: Selected economic indicators data, 26. 11. 2007.

Analysing the sole indicator of unemployment does not provide full picture of the labour market. We should take into consideration the development of employment as well. We may notice that employment decreased (see following chart) in all central European countries. In Poland, the decline was severe and labour force slumped by nearly 9% between 1990 and 2004. On the contrary, the Czech Republic witnessed a small decline. Hungary had by far the smallest participation on the labour market among these countries.

Chart 10: Labour participation rate, total (% of total population ages 15+)



Source: World Databank - World Development Indicators (WDI) & Global Development Finance (GDF); Retrieved December 10, 2010 from http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2

Inflation

Growing prices were considered to be the most serious problem of the Polish economy at the beginning of the transformation process (Dabrowski, 2003). As we have already mentioned, the country suffered from high inflation already at the end of the communist regime. The prices shot up after price liberalisation in the early 1990. The growth reached 100% in January even if the government applied a tough restrictive policy. For comparison, prices in Czechoslovakia increased by only 27% in January 1991 (the first month following price liberalization). The enormous growth in Poland was caused by a monetary excess in the economy (Holman, 2000). The overall growth of price level in the first year of the transformation was more than 580% (EBRD, 26. 11. 2007). Watanabe (2002) reminds us that there was a positive side of hyperinflation because it diminished debts of companies, and thus provided relief for them at the start of the transformation process. In the following years, desinflation took place but its pace was relatively slow, as we can see in the next table. And inflation declined below 5% only in 2002.

Table 19: Development of consumers prices annual average (in %)

	The Czech Republic	Hungary	Poland	Bulgaria	Rumania	Slovakia
1989	1.4	17.0	251.1	6.4	1.1	2.3
1990	9.7	28.9	585.8	26.3	5.1	10.8
1991	52.0	35.0	70.3	333.5	170.2	61.2
1992	11.1	23.0	43.0	82.0	210.4	10.0
1993	20.8	22.5	35.3	73.0	256.1	23.2
1994	9.9	18.8	32.2	96.3	136.7	13.4
1995	9.6	28.2	27.8	62.0	32.3	9.9
1996	8.9	23.6	19.9	123.0	38.8	5.8
1997	8.4	18.3	14.9	1 082.0	154.8	6.1
1998	10.6	14.3	11.8	22.2	59.1	6.7
1999	2.1	10.0	7.3	0.7	45.8	10.6
2000	4.0	9.8	10.1	9.9	45.7	12.0
2001	4.7	9.2	5.5	7.4	34.5	7.3
2002	1.8	5.3	1.9	5.9	22.5	3.3
2003	0.2	4.7	0.8	2.3	15.3	8.5
2004	2.8	6.8	3.5	6.1	11.9	7.5

Source: EBRD: Selected economic indicators data, 26. 11. 2007.

As a consequence, price level increased in Poland to a significantly greater degree than in the Czech Republic during the whole transformation period (see the Table 20). Holman (2000) considers several reasons for this difference – a more restrictive economic policy in the Czech Republic, lower wage requests, differences in tax policy and most of all different exchange rate regime. We can expect that inflation inertia or generally speaking historical circumstances had an influence as well. Dabrowski (2003) reminds us of another factor and it is monetization of public debt. The Polish Central bank financed important part of the government deficit in the first years of transformation. Yet monetary policy in Hungary in this period was much more abused. In addition to that, Polish reformers had a natural advantage in liberalized prices – according to the EBRD, the share of administered prices in CPI in 1989 achieved only 19% (EBRD, 26. 11. 2007). Deregulation of prices was one of the main causes of inflation in the Czech economy during the transformation period.

On the other hand, Janackova (2000) adds that lower inflation in the Czech economy meant that Czech companies were not cleared of the debts from the communist period and thus had to bear relatively higher costs of the transformation against inhabitants.

Table 20: Cumulative growth of prices (1989=100)

	1989	1990	1991	1992	1994	1996	1998	2000	2002	2004
The Czech Republic	100	110	167	185	246	294	352	374	399	411
Hungary	100	129	174	214	311	494	667	806	927	1036
Poland	100	686	1168	1670	2987	4577	5880	6947	7467	7792

Source: EBRD: Selected economic indicators data, 26. 11. 2007, own calculations.

External relationships

In this subchapter we will analyse Polish economic relationships with the rest of the world. We will have a look at development of international trade, foreign investment (mostly FDI) and in short migration.

At the end of the 1980s, Germany and the Soviet Union were the main Polish trading partners. This situation changed in the following years. International trade quickly re-orientated towards the developed markets, and unified Germany in particular became the main trading partner. decline in trade with the ex-COMECOM countries was the mainreason for this shift. Zielinski (1993), for example, writes that the share of the Soviet Union on Polish exports dropped from 31% in 1989 to 11% in 1991 – and the volume slumped from 4% of GDP to 1,5%. During the same period exports to Rumania declined by more than 80%, to Bulgaria by some 75% , to Hungary by 20%; and only exports to Czechoslovakia increased by 20% (all in nominal terms). Total Polish exports into the ex-COMECOM countries declined from 30.8 trillion of zloty to 25.8 trillion, which means a decline of 16% in nominal and 42% in real terms (Zielinski, 1993). Long run development of Polish main trading partners can be seen in the subsequent table.

Table 21: The main Polish trading partners 1929-2004 and their share in Polish trade (in %)

		The 1st Partner	% share	The 2nd Partner	% share	The 3rd Partner	% share
1929	Imports	Germany	27.3	USA	12.5	U.K.	8.5
	Exports	Germany	31.2	Czechoslovakia	10.5	Austria	10.5
1938	Imports	Germany	14.5	USA	12.2	U.K.	11.4
	Exports	U.K.	18.2	Germany	14.5	Sweden	6
1950	Imports	USSR	28.8	Czechoslovakia	13.2	DRG	11.5
	Exports	USSR	24.3	DRG	13.9	Czechoslovakia	9.2
1960	Imports	USSR	31.2	DRG	12.5	Czechoslovakia	8.5
	Exports	USSR	29.4	DRG	9.4	Czechoslovakia	8.5
1970	Imports	USSR	37.7	DRG	11.1	Czechoslovakia	8.6
	Exports	USSR	35.3	DRG	9.3	Czechoslovakia	7.5
1980	Imports	USSR	33.1	FRD	6.7	DRG	6.6
	Exports	USSR	31.2	FRD	8.1	Czechoslovakia	6.9
1985	Imports	USSR	34.4	FRD	9	DRG	6.1
	Exports	USSR	28.4	FRD	8.7	Czechoslovakia	6.2
1990	Imports	Germany	20.1	USSR	19.8	Italy	7.5
	Exports	Germany	25.1	USSR	15.3	U.K.	7.1
1995	Imports	Germany	26.6	Italy	8.5	Russia	6.7
	Exports	Germany	38.3	Netherlands	5.6	Russia	5.6
2000	Imports	Germany	23.9	Russia	9.4	Italy	8.3
	Exports	Germany	34.9	Italy	6.3	France	5.2
2004	Imports	Germany	24.4	Italy	7.9	Russia	7.2
	Exports	Germany	30.1	Italy	6.1	France	6

Note: DRG - Democratic Republic of Germany; FRD - Federal Republic of Germany
Source: Central Statistical Office, Yearbook of Foreign Trade Statistics 2007, 2007

This decline in trade in Central Europe led to an attempt to reverse it and to establishment of the Central European Free Trade Area (CEFTA) in the early 1990s.

The Area was formed by Poland, Hungary, Slovakia and the Czech Republic (other countries joined later). Polish trade with the EU was liberalized during the 1990s as well. But the average Polish tariffs stayed relatively high during the transformation period, as we can see in the following table.

Table 22: The development of average tariffs (in %)

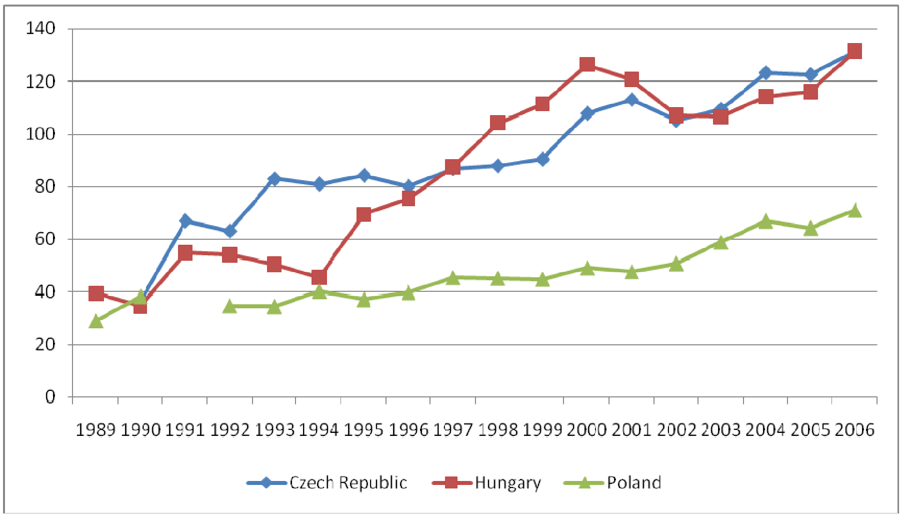
Country	1990	1991	1992	1993	1995	1996
Czech Republic	5.3	-	-	4.8	5.0	7.7
Hungary	-	12.7	12.6	8.5	-	15.2
Poland	-	12.2	11.7	8.5	11.6	18.7

	1997	1999	2000	2001	2002	2003
Czech Republic	7.3	6.8	6.5	6.1	6.0	6.0
Hungary	14.3	12.4	11.9	11.7	9.5	9.5
Poland	13.1	15.9	14.5	12.6	13.9	13.9

Source: Jandova (2007)

In the mean time, regardless of relatively high tariffs, the country had integrated into the world economy. The share of exports and imports in GDP increased from 29% in 1989 to 67% in 2004 (EBRD, 26. 11. 2007). This development can be seen in the subsequent chart.

Chart 11: Trade openness (exports plus imports to GDP in %) in Poland, Hungary and the Czech Republic



Source: EBRD: Selected economic indicators data, 26. 11. 2007.

Poland did not avoid trade imbalance and suffered from a relatively high deficit of the current account at the end of the first transformation decade (see the next table). Nearly all of the transformation economies were struck by similar problems in some phase of the transformation during the 1990s. Only Slovenia (of the whole previous Eastern block) was able to avoid a higher deficit of the current account.

Table 23: The share of the current account balance to GDP between 1990 and 2004 (in %)

Country	1990	1991	1992	1993	1994	1995	1996	1997
Czech R.						-2.5	-6.7	-6.3
Hungary	1.1	1.2	0.9	-10.8	-9.5	-3.6	-3.8	-4.3
Poland	1.9	-0.4	1.0	-1.3	5.3	0.6	-2.1	-3.7

	1998	1999	2000	2001	2002	2003	2004
Czech R.	-2.1	-2.4	-4.7	-5.3	-5.7	-6.3	-5.3
Hungary	-7.0	-7.7	-8.5	-6.0	-7.0	-8.0	-8.4
Poland	-4.0	-7.4	-6.0	-3.1	-2.8	-2.5	-4.0

Source: IMF: World Economic Outlook Database, Retrieved October 9, 2010 from http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx

Regarding capital transfers, we concentrate on the foreign direct investment (FDI). The mood in Poland at the beginning of the transformation period was similar that of other countries, and there was no political support for selling of the domestic companies to foreigners (Berend, 2009). Nevertheless, the country was always among the biggest receivers of FDI in absolute terms, as we can see in the following table. Lavigne (1999), for example, writes that Hungary, Poland and the Czech Republic gained as much as 84% of all FDI in Eastern Europe by 1997. The view of Poland is different if we consider FDI per person (see the next table) because according to this measure the country lagged behind the leaders.

Table 24: Cumulative inflows of FDI in absolute terms and per capita in Eastern Europe 1989-2004

Country	Cumulative FDI inflows 1989-2004, in million US$	Cumulative FID inflows per capita, 1989-2004, in US$
Czech Republic	41 704	4 045
Hungary	37 189	3 719
Poland	56 333	1 471
Total Central Europe and Baltic countries	161 255	2 313

Source: Berend (2009)

As a consequence of foreign investment, companies from abroad are currently playing an increasingly important role in the Central European economies. We can see (the next table) that the role of foreign companies in the industries was already decisive at the end of the 1990s.

Table 25: The share of foreign companies in industry at the end of the 1990s

	Employment	Investment	Sales	Exports
Czech Republic	27	53	42	61
Hungary	47	82	73	89
Poland	29	63	49	59

Source: Berend (2009)

Labour force is the last factor of production. Emigration from Poland declined after 1990, and simultaneously, immigration into the country increased. And as a consequence, net migration declined after 1990. There was another shift in the labour market in the form of sharp growth in emigration after the Polish admission into the EU. The overall development of migration can be seen in Chart 1.

8. Conclusions

The pages above presented us with the development of the Polish economy and society during the transformation period. We could realize that economic conditions changed dramatically. During the period of the communist reign, the economy was decaying, and the economic situation at the end of the 1980s was critical. The economy suffered from slow economic growth, hyperinflation and lack of basic consumer goods. Shock therapy was applied in order to radically change economic conditions in the country. This cure improved the economic situation in the medium-term period but (at the beginning of the 1990s) it brought about transformation recession and hyperinflation in the short-time perspective. Polish economic conditions enormously improved following the overcoming of this recession. Political situation changed quickly during the transformation period and the governments were relatively unstable. Polish economists had to face many tasks – including privatisation and improvement in banking sector. The privatisation process was slow and postponed. Economic growth was relatively high and the economy was able to catch up with developed countries. The main goal of the economic transformation in the form of improving the ability of the economy to grow was achieved. The economy established a growing trend and was able to catch up with developed countries during the transformation and post-transformation period.

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Appendix: Development of the banking system 1989-2004

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Number of banks (foreign-owned)																
Poland	na	na	na	na	87 (10)	82 (11)	81 (18)	81 (25)	81 (28)	83 (31)	77 (39)	73 (46)	69 (46)	59 (45)	58 (46)	57 (44)
Hungary	26 (7)	32 (11)	35 (8)	35 (12)	40 (16)	43 (18)	43 (21)	42 (26)	45 (30)	44 (28)	43 (29)	42 (33)	41 (32)	38 (28)	38 (29)	38 (27)
Czech R.	na	na	na	na	52 (18)	55 (21)	55 (23)	53 (23)	50 (24)	45 (25)	42 (27)	40 (26)	38 (26)	37 (26)	35 (26)	35 (26)
Asset share of foreign-owned banks (in per cent)																
Poland	na	na	na	na	2.8	3.4	4.4	14.4	16.0	17.4	49.3	72.6	72.2	70.7	71.5	71.3
Hungary	5.9	6.9	8.7	9.3	9.4	13.3	36.8	46.2	61.3	59.2	61.5	67.4	66.5	85.0	83.5	63.0
Czech R.	na	na	na	na	7.3	11.2	15.5	19.0	23.3	26.4	38.4	65.4	89.1	85.8	86.3	84.9
Asset share of state-owned banks (in per cent)																
Poland	na	na	na	na	86.2	80.4	71.7	69.8	51.6	48.0	24.9	23.9	24.4	26.6	25.8	21.7
Hungary	85.5	81.2	75.3	74.4	77.2	62.5	50.0	15.3	3.5	9.8	7.8	7.7	9.1	10.7	7.4	6.6
Czech R.	na	na	na	na	77.1	73.8	70.7	69.9	67.5	53.7	41.2	27.8	3.8	4.6	3.0	2.9
Non-performing loans (in per cent of total loans)																
Poland	na	na	na	na	36.4	34.0	23.9	14.7	11.5	11.8	14.9	16.8	20.5	24.7	25.1	17.6
Hungary	na	na	na	na	na	na	na	na	6.6	7.9	4.4	3.1	3.0	4.9	3.8	3.7
Czech R.	na	na	na	na	na	na	40.4	30.6	30.2	31.5	37.8	33.8	14.5	9.4	5.0	4.1

Source: EBRD: Selected economic indicators data, 26. 11. 2007.

TRANSFORMATION IN POLAND

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Abstract: The paper analyses transformation process in Poland between 1989 and 2004. The goal of the paper is to clarify the most important steps in the economic policy that were carried out in this period. The structure of the paper follows this general goal. We first of all analyse economic development of the country before the fall of the communist regime because this determined the whole following process. Then we shortly mention political development that had a significant impact on the transformation process, and its results. In the next part we concentrate on the main steps in the economic transformation, and consequently devote place to specific aspects – for example privatisation. The final part analyses the main economic indicators of this period. We conclude that the transformation process achieved its main economic goal and the economy's ability to grow increased.

Key words: Poland, economic transformation, economic growth

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