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Part I

Imperfect decentralization, broken political contracts and foreign debt crisis

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1 Import-led growth policy under 'soft' planning

The Gierek period has been typically analysed from the point of view of why his economic policies ultimately failed, i.e., what specific forces were responsible for the economic crisis of 1979–82. The period of extremely rapid growth in investment combined with unprecedented gains in real consumption, lasting from 1971 through 1976, and the following years of more modest output growth and wage increases, are usually viewed as a prelude to that crisis. The most common explanation for the economic downturn is that the foreign credits which made the early expansion possible were also responsible for the crisis. Poland borrowed too much, given its absorptive capability and low overall production efficiency. The above view is examined in this opening chapter and throughout the rest of the first part of the book.

The opening of the economy by Gierek's government at the end of 1971 is viewed here as a key element in his ambitious programme of growth expansion, driven not only by a desire to upgrade the ailing national economy but also to quickly raise the standard of living. However, the strategy of active imports – and Western credits, which made them possible – does not seem to be the exclusive, or even primary, cause of the subsequent crisis. Ineffective aggregate demand (income) management – wage-rate and price policies – are identified as additional, possibly more critical, factors responsible for the onset of economic difficulties in 1976, and for Poland's inability to soften the 1979–82 collapse (with some decline in production almost unavoidable due to shocks coming from world markets) (Poznanski 1986a).

In retrospect, the policies of Gierek's government, assessed at the conclusion of his tenure as basically a failure represent an important stage in Poland's reconstruction of an open – we stress, open – market type economy. With the benefit of hindsight, we can look now at Gierek's import-led strategy not as an episode but as a possible phase in a sequence of related events. Although Gierek's decision to 'soften'

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the planning system contributed to the ultimate failure of his ambitious growth programme, it also made it difficult, if not impossible, for Poland to restore the old-fashioned, 'hard' planning regime. While the opening of the economy resulted in an ungovernable foreign debt, it also permanently integrated the country into the world economy. It is in this way that Gierek's policies and reforms set the path for many years to come.

The import-led expansion programme of 1971

When Gierek took over as First Secretary of the Polish United Workers' Party (PUWP) at the end of 1970, Poland's industrial output was both stagnating and visibly falling behind the world technological frontier. Moreover, years of deflationary income policies had had a detrimental impact on labour productivity and work discipline. Gierek's immediate response was to establish limited corrective policies, primarily in the agricultural sector. This was followed by a set of far more radical measures which formed the foundation of the economic expansion of 1971–75. In many respects, Gierek's policies represented a bold attempt to invigorate Poland's economy through a series of interrelated measures – economic and political.

The investment programme

The outstanding feature of the new economic policy was the decision to accelerate investment through an unprecedented buildup of production capacities. By 1975, the volume of investment exceeded the 1970 level by 133 per cent. The share of investment in the national product soared to 29.0 per cent in 1975 from an average of 19.4 per cent for 1965–69 (table 1.1). This spurt was much faster than that of any other East European country at the time. In comparison, Romania, with its very aggressive growth policy, reported an increase in total investment of about 72 per cent over a similar period. Only in Hungary did the share of investment in national product approach that of Poland. Nevertheless, Hungarian investment increases were much less drastic than those of Poland[1] (with Hungary starting from relatively higher investment shares).

Gierek's decision radically to accelerate investment reflected in part his major goal of upgrading and stimulating the stagnating economy.[2] It also reflected his acquiescence to strong systemic forces, whereby industrial units – from enterprises to sectoral ministries – continually

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Table 1.1 *Macroeconomic indicators, Poland, 1970–1979 (annual rates in percentage)*

	Net Material Product produced	Total output		Gross fixed investment	Share of investment in NMP utilized
		Industry	Agriculture		
	(1)	(2)	(3)	(4)	(5)
1970	5.2	8.1	2.2	4.1	20.5
1971	8.1	8.5	8.3	10.2	20.6
1972	10.6	10.4	5.4	26.7	23.3
1973	10.8	11.6	3.4	27.7	25.9
1974	10.4	12.0	−2.9	22.3	28.3
1975	9.0	11.4	−8.1	12.1	29.0
1976	6.8	9.1	2.0	−.9	27.0
1977	5.0	7.6	.2	2.7	27.1
1978	3.0	2.7	7.3	−4.0	25.9
1979	−2.3	−1.7	−5.6	−15.4	22.7

	Inflation (CPI)	Real wages	Real consumption	Productivity of	
				Labour	Capital
	(6)	(7)	(8)	(9)	(10)
1970	–	–	–	–	–
1971	−1.2	5.7	7.0	6.9	1.8
1972	.0	6.4	8.8	8.6	3.8
1973	2.6	8.7	8.6	9.0	3.0
1974	6.8	6.6	6.8	8.2	1.0
1975	3.0	8.5	11.2	8.3	−1.1
1976	4.7	3.9	8.6	7.7	−2.5
1977	4.9	2.3	6.5	5.0	−4.3
1978	8.7	−2.7	1.1	3.3	−5.3
1979	6.7	2.4	3.3	−1.5	−9.6

Source: Rocznik Statystyczny, Warsaw, GUS (various years); *Government Report on the State of the Economy*, 1981, Warsaw (July).

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seek investment. In the past, Polish leaders succeeded in restraining the 'expansion drives' and 'investment hunger' of the industrial units by ensuring that the economy faced relatively 'hard' budget constraints (e.g., shortages of hard currency to pay for foreign equipment and limited physical capacity of the construction industry). In contrast, Gierek did not restrain the investment pressure and in fact allowed foreign financing to be used for this purpose.[3]

Acceding to administrative pressures for higher investment also permitted Gierek to obtain support among important political actors in the state bureaucracy. When Gierek assumed the post of the First Secretary, a large number of activists with strong industrial backgrounds were in fact elevated to high political positions. This group showed much less concern for balancing the budget than had previous leadership elites. Almost none of the top leaders under Gierek stood for the same fiscal restraints as did the old 'watchdogs' of balanced plans under Bierut (e.g., Minc and Szyr) or Gomulka (e.g., Jedrychowski and Jaszczuk). The major investment drive of the early 1970s had, therefore, the backing of the top leadership, the state bureaucracy, and the industrial units.

Income policy

Another important policy change was the decision to accelerate the growth of real income in the 1970s. This policy had the dual goal of placating workers and eliciting greater work effort and labour discipline. By offering a 'social compact' – that is, trading a promise of continuous wage improvement for political compliance – the party hoped to buy political stability. Theoretically, the compromise was to be the ideal solution, since higher wages would also increase worker productivity – which, of course, would be crucial for the success of Poland's drive to revitalize its fledgling economy.

During the 1966–70 period, real wages grew more slowly in Poland than elsewhere in Eastern Europe, and Gierek felt compelled by the demands of industrial workers to achieve income growth with relatively stable prices. Ironically, although the unpopular price increase which Gomulka imposed in 1970 was a prime factor in Gierek's rise to power, Gierek had initially resisted workers' demands to roll back the price increases. However, when faced with massive strikes in Lodz in February 1971, he restored the old prices and promised not to raise the price of necessities over the next few years. The 1971 decision in fact marked a turnaround in traditional labour

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policy, under which decisions on wages/ prices were made unilaterally by the party.

The actual increase in income levels greatly exceeded the earlier plans for rapid growth in the level of personal consumption. Between 1971 and 1975, nominal wages increased at an average of 9.6 per cent a year, or more than three times the original plan figure. The annual rate of growth of real wages was around 6.8 per cent, several times above the level permitted under Gomulka. It was also more than twice the rates in the two other East European countries that had adopted models of 'consumer socialism', East Germany and Hungary. The main mechanism for transmitting the sizeable wage increases was the unexpectedly high rate of growth in revenues of industrial associations. The other factor was the centrally instituted reforms in the wage schemes of particular trades and in the retirement system.

Gierek's willingness to allow rapid income expansion clearly differed from the behaviour of other incoming party leaders in post-war Eastern Europe. New regimes, of course, often attempted to gain popularity by temporarily allowing incomes to grow faster while allocating more resources to the consumer goods industries. For example, Gomulka followed this strategy during the 1956–57 period. However, in the case of Gierek, the decision to allow consumption to increase was (or was perceived to be) a long-term commitment, partly intentional and partly forced on him by the political leverage of the workers at the time.

The intentional aspect of the income policy reflected the new political philosophy of Gierek and his entourage. The new approach called upon the party to 'earn' its authority not through political indoctrination and threats but rather through the satisfaction of consumer preferences. Gierek had tried this approach successfully in Silesia long before his appointment as PUWP First Secretary. Under his jurisdiction, Silesia boasted both the best-supplied shops and the most disciplined workforce in the country. Hence, Gierek's wage and price policy through the mid-1970s represented an attempt at instituting a type of 'efficiency wage' economy – improving the living standard of workers in the expectation of eliciting greater work effort.

Western assistance

Unlike his predecessors, Gierek did not hesitate to open the economy to outside contacts. The principal purpose was to engage Western economies in Poland's expansion programme by increasing supplies of

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imported consumer goods for which society was hungry, but even more (or predominantly) by raising the share of imported capital equipment in total investment. In the short run, the economy was expected to benefit from larger consumer imports as a means of motivating labour to work more productively, while in the long run, the success of the rapid-growth strategy relied mostly on the ability of the government to channel Western imports into the capital sector (which was in great need of modern technology not available in the Soviet bloc).

There were two basic options available to the communist leadership of Gierek. The first was to increase the share of export revenues which was allocated to imports of Western machinery and equipment and increase this category of imports in absolute terms, when exports, hopefully, had expanded. But there were rather serious limits to this type of strategy, since most of the hard-currency imports were already directed to these goods (and related supplies of intermediate products). Moreover, the government could hardly expect hard-currency exports to rapidly expand in the short-run due to supply constraints (i.e., low quality of goods).

Another solution was to increase resources for imports through external borrowing. In this case, Poland would allow its imports to exceed its exports and finance the resultant trade deficits with foreign credits. These credits would then have to be paid back through additional exports created with the help of imported machinery and/or by directing more of the existing supplies of exportables to the world market. This strategy of import-led growth was promising, provided that sufficient external funds were not only made available to the country but also were offered at a reasonable price, i.e., at a good rate of interest, and with a sufficient grace period for investment projects to be finished before payments culminate.

Gierek's government decided to choose this second option as promising faster results, even though relying on large-scale foreign credits as an engine of growth carried a higher risk. To begin with, if external financing were allowed to support domestic consumption (including a welfare programme), then the national economy could end up unprepared for debt repayment. Similarly, if imported capital were applied inefficiently, then production potential built with foreign credits would not be sufficient to pay in full the cost of borrowed money. It follows that for a credit-driven strategy to work, the economy would have to be able to resist excessive wage demands while providing strong incentives for capital users to apply imported inputs most effectively.

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If foreign credits were not properly utilized, the country could find itself in a 'debt trap', where even the utmost effort to mobilize existing export potentials and to execute drastic import reductions would fail to stabilize the level of outstanding payments, far less to lower them to an acceptable size. With an insufficient trade surplus, the national economy could be forced to roll over part of its foreign debt again and again, while lenders grew increasingly reluctant to lend money and, if they opened fresh credit lines at all, would charge higher interest rates. The costs of servicing such an uncontrollable debt burden might exceed the benefit of the original foreign credits, thus making the import-led strategy counter-productive.

Geopolitical aspect

The normalization treaty negotiated with West Germany by Gomulka and signed in early 1970, helped to create a more favourable political climate for borrowing. Importantly, when Gierek assumed power in 1970, the Soviet Union was already in its fourth or fifth year of trying to gradually reduce political tensions with the Western powers. The Soviet leaders needed this improvement as their economy was in great need of modernization, which required increased supplies of advanced Western products. To maximize the benefits of such an opening, the Soviet leadership instructed its East European partners to also engage in more intense economic exchanges with the West in order to upgrade East European exports to the Soviet economy.

An important internal reason for adopting such an intense borrowing policy in Poland was that Gierek was attempting to use economic ties with the West to emancipate himself somewhat from Soviet control. Unlike many leaders in Eastern Europe, Gierek had not been mandated by the Soviet Union but rather had been internally elected by the Polish party. His ability to build a strong domestic base enabled him to pursue a more independent political line, freer of Soviet interference. Such a shift had the advantage of appealing to the traditionally strong nationalist currents within the Polish party. Increased political independence was also helpful in building broad support with the public, which exhibited strong anti-Soviet feelings.

The above features of Poland's political scene made the country particularly attractive to Western governments seeking ways to weaken Soviet control over Eastern Europe, but, economically, Poland appealed to the West as well. With the largest single East European market, Poland seemed most suitable to Western investors, and her

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strong sympathy for Western culture – and its consumption pattern – was seen as a positive factor as well. The extensive presence of private activities, basically in the agricultural sector, made Poland far more desirable than most of the other East European economies. Poland also had an advantage in possessing minerals and fuels sought after by manufacturing industries in the Western world. With large deposits of sulphur, copper, and coal, Poland could be expected to readily mobilize hard-currency revenues if its trade balance got out of control.

Gierek's interest in opening up the Polish economy coincided with the effort by Western countries to stimulate the sale of their products in Eastern Europe and the Soviet Union. Consequently, Western countries adopted a policy of liberalizing restrictions on the transfer of technology while providing generous credits.[4] These efforts of Western countries intensified after the 1973 oil price shock as the search for export markets increased and the need to recycle petrodollars emerged. Neither oil countries nor Western economies were in a position to absorb the excess money supply, so that credits were made available to others on attractive conditions (see Tyson 1985).

The Polish government took full advantage of these external opportunities. Whereas Poland showed a positive balance of trade with Western countries in 1971, a year later, it incurred large trade deficits: the largest increase in its deficit occurred in 1973, reflecting the sudden increase in the accessibility of Western credits. The gross debt to the West increased rapidly from a manageable 1.1 billion dollars in 1971 to an already worrisome 8.4 billion dollars in 1975 (and then to a crisis-genic 23.7 billion dollars in 1979). Although similar strategies of deficit financed growth acceleration were adopted by other East European countries (and to a lesser extent in the Soviet Union), none except for Hungary and Romania pursued foreign borrowing as aggressively and as early as Poland.

Technology switch

These developments in the external sector were accompanied by a sharp increase of technology imports from the West, particularly from Western Europe. Polish imports of Western technology resumed in 1958, intensified around 1965, and then experienced their most rapid acceleration in 1971. This surge in technology imports from Western economies is well reflected in licence statistics, showing that Poland purchased mostly from Western sources about eleven licences annually between 1958 and 1964, approximately twenty-two licences a year

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during the 1965–70 period, and an average of forty-four between 1971 and 1976.[5] The peak occurred in 1974, when fifty-seven contracts were signed (see table 1.2). Between 1972 and 1978, the total royalty payments on licences virtually tripled from $28 million to $81 million.

A similar pattern can be observed in many other Eastern European countries, although the data are too fragmentary to allow a precise comparison.[6] In Hungary, as in Poland, the number of all (not only Western) licence agreements tripled in the seventies (from eighteen per annum in 1970 to around sixty-two during 1975–77). In Czechoslovakia, imports of licences increased significantly in the late seventies as compared to the first half of the decade (i.e., an average of thirty-six contracts in 1970–74 against fifty-six agreements signed annually during 1975–79). However, the Czechoslovak figures for the late seventies exceeded only by one fourth those for the last few years of the sixties (an average of forty-three contracts in 1966–69). In contrast, no significant upturn in East German licence imports took place in the 1970s.

In the late 1960s, Poland was one of the least active East European countries in terms of attracting (being granted) Western patents. With an average of 350 patents granted in 1967–69, Poland was well behind East Germany with 1,245 patents, Czechoslovakia with 737, and Hungary with 513. With the acceleration that took place in the 1970s, Poland reduced its gap with the leaders as the cumulative number of patents granted to Poland in 1973–78 amounted to 8,318, which was still less than that granted to East Germany (12,660 patents), though very close to Czechoslovakia (9,104 patents), and more than Hungary (5,462 patents). However, even during this period of acceleration, the number of Western patents per capita was lower in Poland than in the other three countries (though above that reported by Romania).

Almost simultaneously with the aforementioned acceleration of licence agreements in 1971, Poland began to expand rapidly its purchases of Western machinery and equipment, a major source of embodied foreign technology.[7] In fact, a large fraction of the machinery and equipment imports was needed to implement the acquired licences.[8] This acceleration is reflected in the statistics on Polish imports of machinery and transport equipment (SITC7) from the OECD countries, and in the data on purchases of specialized machinery and metalworking machinery (SITC7.2 and SITC7.3) (see appendix 1). The latter may be considered more accurate since they represent active capital – unlike some other product categories which are broadly classified as machinery and transport equipment.

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