Recent Developments in Poland

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I would like to make some comments on the new economic program in Poland. Poland started to implement reforms at the beginning of this year. There are two principal goals of this program. The first goal is to curb the inflationary process quickly and permanently, and eliminate a shortage of goods in the market. The second goal is to transform the economic system into a market economy, which requires ownership changes, privatization, demonopolization, and other institutional changes.

During the first months of this year, many steps were undertaken to curb inflation and to start the process of transformation of the economy. The main points of the reform package implemented since the beginning of 1990 are:

— liberalization of all prices;

— rapid elimination of the budget deficit;

— restrictions on wage increases;

— tax measures;

— unification and stabilization of the exchange rate, along with the partial convertibility of the domestic currency;

— consistent anti-inflationary monetary policy, including higher interest rates to limit credit demand and to create incentives for savings (introducing the principle that interest rates remain positive in real terms);

— introduction of money and capital market instruments and institutions;

— the introduction of an anti-monopoly policy involving the promotion and the formation of new economic units, stressing changes of ownership through privatization of state-owned firms and companies; and

— lowering of restrictions on imports from Western countries.

What are the results through the first half of the year? First, the monthly inflation rate went down from about 80 percent in January to 3.5 percent in June and July, and we expect further declines. In the fourth quarter of this year, according to our forecasts, the rate of inflation should be about 1 percent per month. Second, the internal market situation has been improved, and demand and supply relationships are now in balance. *Third,* exports have gone up by more than 20 percent in real terms, and imports have gone down by more than 20 percent. The surplus in the trade balance has resulted in increasing foreign exchange reserves. The exchange rate has been stable, and there has been no limit on the access of economic units or of the people to foreign exchange.

In introducing fundamental changes in the economic system, we expected production and consumption would decrease. However, the decrease is greater than had been estimated. Output has fallen by 30 percent—especially in consumer goods production, which has fallen by 40 percent. Total employment has decreased significantly, and real household income has gone down 30 percent. But real incomes cannot be cut further. Instead, future progress toward price stability must be achieved by raising the level of economic activity. So, we think that conditions are now right to proceed to the next stage of the overall transformation of our economy—that is, institutional transformation and structural changes in the economy. This new stage requires stable economic growth.

The National Bank of Poland, in its role as a central bank, will play an important role of guiding the transformation of the Polish economy. What are the main responsibilities? First, the central bank of Poland is responsible for setting the exchange rate and controlling capital movements. It is also responsible for controlling the total volume of domestic bank credit, which is closely connected with the balance of payments. In regulating the volume of credit, the central bank of course has to take into account the monetary impact of Treasury policy and the actions of nonbanking credit institutions. The central bank is also responsible to some extent for the distribution of bank credit among different economic activities, especially the distribution among the public and private sectors. The final major responsibility of the Bank of Poland is the formulation of policies dealing with interest rates and their effects on the types and volume of savings and credit.

Of course, traditionally it is quite evident that the National Bank of Poland is responsible for managing the payments system in the country. And during the period of transition, the need for action by the National Bank of Poland is greater than in normal times because there is a lack of financial institutions and capital markets—and of course there is the additional problem of developing a banking system. In this period, we have to perform functions normally performed by such institutions.

We face major problems in the conduct of monetary policy. Based on the experience of advanced countries, we believe that monetary policy is but one of the alternatives for general economic policies, but that the primary goal of monetary policy should be domestic price stability. So we have oriented our monetary policy toward achieving this goal. The first element of interest rate policy was to assure confidence in the banking system by introducing a positive interest rate. At the beginning of this year, we implemented a program to link interest rates to the rate of inflation. I think that we can say that this strategy has been very successful. The propensity to save has increased, and we have begun the process of stabilizing the economy. Confidence in the zloty, the Polish internal currency, has grown. This increased confidence is a very important factor for future policy.

That has raised another point of interest rate policy and inflation policy. It is necessary to treat inflation policy as a function also of interest rate policy. And we have decided to take account of the decrease of inflationary expectations in setting our interest rate policy. So I think that we now have created more stable conditions to promote economic activity. Doing so was necessary because in the first part of the year the decline in production was very significant, about 30 percent. I think that as a result of the measures that were taken, the economy has begun to recover in recent months. It is not only economically but also politically a very essential point.

We are convinced that in transforming our economy from a centrally planned to a free market economy, transforming the banking system must play a key role. I am convinced that the main problem in our situation is to create and maintain confidence in the banking system. Without such confidence, it would be absolutely impossible for the banking system to fulfill its direct role in the transformation from a centrally planned economy to a market-oriented economy.

And after our initial experience in the transformation of the Polish economy and the development of the Polish banking system, we feel also that the three functions of a banking system discussed by President Corrigan—involving the development and stabilization of the working of the financial system, including the payments system—are very important. The development of effective supervision of the banking system is also very important. The quality and efficiency of monetary policy depends on a safe and efficient banking system.

The reform of the Polish banking system started in 1989 when, under the new banking law, a two-tier structure of banking was introduced involving the central bank—the National Bank of Poland—as well as commercial banks. The function of the central bank was separated from the commercial banking function. The NBP—National Bank of Poland—now acts as a central bank like those in Western countries.

Under the new banking law, nine commercial banks were established to replace the former regional branches of the NBP. By July 1990 the NBP granted about 60 licenses for the establishment of commercial banks. Many of them are private banks, as well as some banks with foreign capital participation. So we have changed fundamentally the structure of the banking sector. All these banks function as typical commercial banks. Because the biggest banks are still the state-owned banks, there is a problem with privatization of these banks. We have prepared a privatization program, but there is a lack of capital. So we have invited foreign banks to participate in the implementation of this program. Of course, in reorganizing the banking sector, a great deal should be done with the modernization of banking infrastructure—banking management techniques, data transmission, and introduction of modern bank accounting. We have organized a banking school with the participation of foreign banks to teach the new techniques, so that our bankers can adopt modem banking methods.

The problem of banking supervision now is becoming very important because in the situation where new banking institutions are being established, there are very new problems connected with unsound banks. This year, a system of banking supervision has been established, and before the end of the year we intend to have in place prudential regulation dealing with loan quality, capital adequacy, and foreign exchange exposure. A first step in this process will be the introduction of revised accounting procedures to become effective by November 1990. Full audits and comprehensive diagnostic studies of the banks are also under way to provide a basis for institutional strengthening. So this project is very ambitious. We are looking for an efficient system of banking supervision; and I think that if we use the experience of our Western colleagues, this task will be completed efficiently and soon.

We will expedite the development of money markets, too, through a regular auction of National Bank of Poland bills starting in July. Now under preparation is the system of Treasury bills and other institutions. Pending the introduction of a completely new domestic payments system, internal improvement will be made in the second half of this year to speed up the execution of payments through the banking system. It is a very essential factor for confidence in the banking system. We have benefited from help—especially from the Federal Reserve, the Bank of France, and the Bank of England—in creating an efficient payments system.

I would like to add that in the shaping of our banking system, we are carefully monitoring changes in Western Europe. I think that the reunification of Europe will help shape the transformation of our banking system as well. This transformation, we hope, will contribute to the very important goal of European integration of economic as well as other aspects of social and political life.

I think that our experience with exchange rate policies is also very instructive. As you know, we introduced so-called internal convertibility of our currency at the beginning of the year, and we freed the exchange rate. Over the past seven months, there were no problems with maintaining stable exchange rates; nor were there problems with assuring access to foreign currency. I would like to emphasize that we designed this policy at the end of last year because we had made a series of devaluations of the zloty. And we deliberately overshot the equilibrium exchange rate at the beginning of this year. Last year, prices increased about twelvefold, and the rate of exchange increased nineteenfold. So at the beginning of this year, the rate of exchange was 9,521 zloty to one dollar. In the first seven months of this year, the rate of inflation was 180 per cent, yet we have not further devalued the zloty. As a result, in the internal market in Poland, the dollar has lost about 60 per cent of its value. However, there is no problem for the future because our international reserves have grown very significantly. This policy was very effective in establishing confidence in the Polish currency. And I think that it was a very good choice in our priorities.

The central problem for the central bank in our country—a problem that also exists in other countries—is the relation between the government and the central bank. In the Western world, the degree of autonomy the central bank enjoys varies from country to country. There is no single model. We have chosen the model of very great autonomy for the central bank because our experience so far—with monetary policy, inflationary pressure, and the attitude of government officials regarding their preeminent role—convinced us of the need to fundamentally alter the relation between the government and the central bank. And according to the new banking law, the central bank enjoys independence. The National Bank of Poland is expressly prohibited from financing the budget deficit. Also, the central bank may not finance state enterprises. Finally, the program of monetary and credit policy is directly presented by the central bank to parliament. Of course, the government presents its opinion, but parliament has to decide in the case of differences of opinion what should be the choice.

However, it is also quite evident that for the stabilization of prices, a mix of policies is necessary. So there must be some collaboration between the government and the central bank. And I think that this idea, which is developed in the practice of the Federal Reserve—the independence of a central bank within the government—is a very good idea. But this idea should be adapted to each concrete condition. In Poland, we are looking for a way to make this idea concrete in our situation. As an example, the president of the National Bank of Poland is appointed by parliament upon recommendation by the president, as is the prime minister. At the moment, this system is very efficient; but I think that it depends very deeply on how much weight the government places on restraining inflation.