An analysis of the collapse of Polish economy in between 1980 – 1989

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Introduction and historical overview
After the disaster of the Second World War Poland ended up in the Soviet sphere of influence. Despite the country’s significant contribution to the Allied victory, the US and Britain agreed to let Stalin organize the restored Polish state. Eastern part of Poland, 48% of the pre-war territory, was ceased to the Soviet Union. In return, the German territories east from the river Oder were annexed to Poland. The Polish speaking population was removed by force from the eastern regions and sent to settle in the new regions in the west. As a result of the war and border changes, the population shrank from 35.1 mln to only 23.9 mln. The material losses from the war and brutal occupation were equal to 13 times the amount of 1938 GNP. The reconstruction of the country lasted for the next 30 years however much of the historical and cultural heritage perished forever. The pace of development of the People’s Republic of Poland was slow but quite steady until early seventies, when the government of Edward Gierek decided to take large foreign development loans. These loans were then invested in technologies that were either too old or had no growth perspective. The last batch of that credit was paid in 2012.1

The economic collapse
In the early eighties the Polish economy was in downfall, caused by the inefficient system, debt servicing, and speeded up by the series of massive strikes of the workers. After the labor protests of 1980, the authorities agreed to sign the Gdansk Agreement, which acknowledged the right of employees to associate in free trade unions, abolished work on weekends, increased the minimum wage, obliged the government to take steps to eliminate censorship, improved and extended welfare and pensions, and increased autonomy of industrial enterprises, where a meaningful role was to be played by workers' self-management councils. On 17 September 1980 independent union representatives gathered in Gdansk to form the national trade union ‘Solidarity’ led by Lech Walesa. The number of members soon skyrocketed to reach 10 million a year later - 1/3 of the total working population in Poland. Due to the catastrophic condition of the economy, the government did not implement the Gdansk agreement social reforms. The result was a nationwide strike organized by the Solidarity, which only led to the further deterioration of the economy.2

Policy reforms and their implications
In the middle of the 80s became obvious that the reforms program, adopted as a result of the ‘August Agreements’ in 1980 was a failure. The first stage of this reforms, 320 bills and 12 000 other law acts enacted during the first four years (1981-1985) destabilized the economy even further. The main flaws of the Polish economy at the time: the dominance of state property, lack of foreign currency liquidity, market shortages, inflation and technological backwardness connected with market decapitalisation – all remained unchanged. Minor periodic improvements in the condition of the economy were – according to the economist Ryszard Bugaj – only a result of ‘activation of the remnants of extensive reserves at the expense of lower consumption’.3

In 1985 a second stage of the reform has started. The plan put greater emphasis on creating conditions for equal competition between private and state owned industries and opening to foreign capital. It did not, however, provide market-oriented introduction of free pricing and liquidation of central distribution

1 Kaczmarek, R., Historia Polski 1914-89, 2010
2 Kemp-Welch, A., Birth of Solidarity, 1983, p. 207
3 Bugaj, R., Dylematy finansow publicznych: przekształcenia w gospodarce polskiej, 2002, p. 23
of raw materials. It only promised the resignation from the strategy of ‘small steps’ towards ‘radical changes’ - without clearly specifying them.

This program was implemented by the government of Zbigniew Messner (November 6, 1985 - September 19, 1988). Minor reforms of the economy, the apparent price liberalization (elimination of regulated prices was accompanied by an extension of contract prices, not subject to market game) did not arouse enthusiasm. An attempt to create the foundations of the capital market by the Act on Bonds (1985) which gave the government right to a free bond issue boiled down to one thing – buyout of securities to acquire scarce goods, (washing machines, etc.), all manufactured by the issuer.4

The society rejected the proposed ‘Radical Economic Recovery’ and ‘Polish Democratization Model’ plans in the referendum conducted on November 29, 1987. The Messner cabinet resigned next year, on September 19, 1988 after a new wave of strikes and protests caused by the rapid increase in food prices. In the winter of 1988 the budget deficit already exceeded 10% of GDP, poorly prepared food market liberalization stimulated uncontrolled inflation (at the end of the year it will approach 60%) This resulted in dollarization of commerce, rising the inflation rate even higher. Production was declining rapidly, there were more and more problems with the supply of basic goods and foreign debt was growing uncontrollably.

Along with the deepening of the economic recession the government became slowly aware of the failure of the reforms. The decision was made to begin the process of getting closer with the openly functioning ‘Solidarity’ opposition. In September 1988 government officials started to meet regularly in Magdalenka, a small village next to Warsaw, with the opposition representatives. The Catholic Church was coordinating the talks. The Magdalenka talks prepared the Round Table. 5

Market reforms

Despite the lack of public confidence the new government of Mieczysław Rakowski, after taking office on October 14, 1988 announced the continuation of reforms, and even their radicalization. In the exposé a new prime minister painted a vision of building a "socialist market economy" based on liberal economic policy and independence of enterprises guided by the principles of rationality and economic calculation. For the first time the communist government declared its support for small private companies. The new approach to the economy is perfectly exemplified in a decision taken on October 10th - to liquidate the unprofitable Gdansk Shipyard.

The Rakowski government reforms, called Consolidation Program of National Economy, had three foundations:

• “Act on Economic Activity”, enacted on December 23, 1988 (Dz.U.1988, No. 41, pos. 324)
• "Act on businesses with foreign ownership” (Dz.U.1988 No. 41, pos. 325)
• "Act on certain conditions for the consolidation of the economy (Dz. U. 1989, No. 10, pos. 57)

Revolutionary for its time were, especially, the provisions of the Economic Activity Act - known as Wilczek’s Act from the name of the lead author, Mieczysław Wilczek, industry minister in the Rakowski government and a businessman himself. Wilczek’s Act stipulated that pursuit of economic activity is free to anyone and in the sphere of economic activity everything that is not prohibited by law is allowed. This meant - contrary to the still existing socialist dogma of the superiority of state-owned enterprises and the social ownership of the means of production - equal rights for all entities - state-owned, cooperative and private. Equal rights were introduced both in terms of law and in terms of access to credit and to still partially regulated goods. Freedom in the forms and types of business activity was unprecedented.6

With only 54 articles (the current law on freedom of economic activity from 2004 consists of 111 articles) "Constitution of economic freedom" maximally simplified the legal requirements to pursue economic activity by an individual – a simple notification, also in the form of a letter to the local authorities was enough. The constitution limited the number of activities, for which the license was required to

4 Bugaj, R., Dylematy finansów publicznych: przekształcenia w gospodarce polskiej, 2002, p. 23
5 Jabłoński, M., Stepka, S., Suliowski, S., Polski rok 1989: sukcesy, zaniechania, porażki - Część 1, p. 187
6 Brzeziecki, A., Burnetko, K., Skoczylas, J., Wałęsa, ludzie, epoka, 2005, p. 252
specifically 12 industries, including defense, energy production, alcohol and tobacco industry. The constraints on the amount of workers hired by a private entrepreneur, as well as the obligation to use the employment agencies were abolished.

The bill regulating the foreign owned and partially foreign owned enterprises enacted on the same day was also very liberal. According to it, foreign ownership of the company could reach 100%. What is more, machinery and equipment necessary to conduct business activity were duty-free. Finally, getting permission to open a company meant also 3 years of tax holidays, with the chance to extend it to 6 years if the company operated in an industry sector labelled by the state as preferred. The capital requirements to open a company started from $2500.  

In February 1989 the parliament enacted the ‘Law on some of the conditions of consolidation of the economy’. The law sanctioned the decentralization of the economy through the elimination of associations of enterprises and simplification of the removal procedure for directors of state enterprises. On the other hand the law was not precise about the rules and possibilities of transferring the assets of state-owned enterprises to private owners. The interpretation discrepancies of the new law not only disrupted the everyday functioning of companies, but also opened the door to some debatable privatizations of state-owned companies. Some scholars recognize it nowadays as the act that started the phenomenon of the many debatable acquisitions of the state-owned property by the party nomenclature and people having connections to it.

Another law, passed on Feb. 15, 1989 as a part of the economic reform was the Foreign Exchange Act (Dz. U. 1989, no. 6, pos. 33). It introduced the internal convertibility of the Polish Zloty. Article 10 allowed the trading of foreign exchange in the registered exchange offices without constraining the fluctuations of the rate in any way. Enterprises were still, however, obliged to resell the obtained foreign currencies to the state, they had no right to hold foreign exchange accounts either in the country or abroad (with the exception of Polish Foreign Exchange banks). A legal prohibition on the use of Polish Zloty as a currency invoicing and payment in foreign trade was in place- which basically predetermined the purely internal nature of Polish currency. 

Reform package was completed with the changes in the banking system and tax introduced in January 1989:

- Banking Law (Dz. U., 1989, no. 4, pos. 21)
- The Polish National Bank Law (Dz. U., 1989, no. 4, pos. 22)
- Law on income tax from legal persons (Dz. U. 1989 No. 3 item 12)

‘Banking’ laws meant a major reconstruction of the banking system. The foundation of changes was the introduction of the two level banking system. First level was the central bank, which only functions was the emission of the currency and being the commercial banks’ bank. Second level was 9 state-owned commercial banks.

The central bank thus became an important element of the economic policy and financial state, and at the same time supervisory authority over commercial banks. The latter, in turn, as fully independent, competing with each other, gained the freedom to decide on the subject and scope of their activities: what kinds of banking services to offer, the level of the interest rate on deposits and loans etc. In accordance with the Banking Law, banks have been however obliged to maintain the liquidity and security of the funds entrusted to them by their customers. This was supervised (e.g. by preventing excessive concentration of loans and excessive capital investments) by the central bank, as the Chief Inspectorate of Banking Supervision. The central bank could also provide the refinancing loan (to check) to the commercial banks.

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7 Ibidem, p.323
8 Wróbel, S., Transformacja ustrojowa w Europie Środkowo-Wschodniej: Płaszczyzny, wymiary, kierunki, 2010, p.121
An important element of the new banking system was also more organized relations between the banking system and the State Treasury through the elimination of the automatic granting of loans for government (partnership instead of subordination).

The law on income tax from legal persons was the first one in Poland to introduce the notion of CIT tax. It also introduced pro-market changes in a chaotic tax system of the People’s Republic of Poland, by setting universally applicable rules on the taxation of the income of all legal persons, regardless of their sector (entities of the socialized or non-socialized economy).

The whole statutory-organizational reform was topped by the transformation of the symbol of the central control of the economy - Planning Commission – into the Central Office of Planning – with only advisory and consultative prerogatives, and not, as in the case of the Planning Commission - the body in charge of the current management of the economy.

Since the beginning of 1989 rationing of gasoline and coal was abolished, as well as ration cards for cars, and from August 1 rationing of meat and meat products – prices since then were determined by the market.

A package of Consolidation Program laws was a major step towards the transformation of the socialist economy into a free market. However, the package didn’t include the necessary system reforms. The effects of the reforms were mainly a massive increase in the number of private enterprises (600,000 by the end of 1989) and a small increase in the value of foreign investment in the country. 10

Increasing decapitalisation of the economy, the lack of external credit, paralysis of state institutions and the need to "mute" social discon tent with budgetary spending in the mid-1989 led to a budget deficit reaching 12 percent of GDP. Foreign debt at the end of the year exceeded $ 40 billion. The introduction of the full liberalization of the food market has led to rampant hyperinflation. During the whole year prices increased by 251 % - all that with negative real interest rates.

The only lasting effect of the Program was the Act on Economic Freedom, which, although heavily diluted, stayed in force until the end of the year 2000.

Conclusions
The collapse of the Polish economy in the 80s was mainly a result of the inefficient central planning system. In the post-war years, society was tired with war and mostly accepted the new state of affairs. As the public rage accumulated it was more and more difficult for the government to control the people. The fact that the authorities where controlled by Moscow certainly didn’t help. In the 70s public discontent was muted by foreign loans. In the 80s the government could find the way to control it which resulted in the massive strikes of workers and rapid deterioration of the economy. The government was not determined enough to implement the necessary market reforms, limited also by the socialist dogma. Those reforms were only possible after the first free elections and became known as the Balcerowicz shock therapy.

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