Exchange Rate Policy and Development of a Transition Economy in Central-Eastern Europe: A Case Study of Poland[1]

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Introduction

The purpose of this paper is to review the development of the Polish transition economy, viewed in the light of its evolution of an exchange rate policy. In other words, we are going to investigate what the development of a transition economy has to do with an adopted exchange rate policy, with reference mainly to Poland.

Maybe I should answer two questions: Why Poland? Why focus on exchange rate policy?

Poland has often been referred to as a success story of transition economy. The received wisdom is that despite initial difficult conditions, Poland took a plunge into an unprecedented radical reform, quickly achieved macroeconomic stabilization and entered a steady economic growth path. Based on its experience, lessons have been drawn and much advice has been given to other less advanced transition countries. Considering its performance since 1990 and its reputation, Poland deserves being studied as a model of transition economy.

We should realize that there is a prevalent myth attributing a spectacular economic improvement in Poland exclusively to the package of macroeconomic stabilization policies of January 1990, the so-called Balcerowicz program or Polish "Big Bang". It is broadly believed that the Balcerowicz program is a typical and successful "shock therapy".

In fact, monetary policy including exchange rate policy was a key component of the stability package. On January 1, 1990 the Polish zloty was devaluated by 43%. At the same time internal convertibility was introduced for the first time among the post-socialist countries. I think that these measures determined much of the course and pace of the transition economy in Poland.

Observing transition economies in Central-Eastern Europe, I am inclined to think that exchange rate policy which is assumed to adjust internal macro disequilibrium, rather than external imbalances, has been one of key policies peculiar to the transition period. It is worth studying a specific role of an exchange rate policy to a transition economy, the characteristic of which is a pursuit of two contradictory targets, i.e. stability and dynamism.

These are the reasons for selecting exchange rate policy as the main viewpoint of the Polish economy at transition.

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Table 1. GDP growth rates

real growth rate: %

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP	-11.6	-7.0	2.6	3.8	5.2	7.0	6.1	6.9	4.8	4.1	4.0
Industry	-24.2	-11.9	2.8	8.6	10.3	10.4	8.3	11.5	3.5	3.6	7.2
Construction	-10.7	1.6	-0.6	1.1	2.7	5.6	3.0	16.5	12.4	6.2	1.0
Agriculture	-2.2	-1.6	-12.7	7.0	-15.1	10.7	0.7	-0.2	5.9	-5.2	-5.6
Consumption	-15.3	6.3	2.6	5.4	4.4	3.3	8.3	6.8	4.7	5.2	2.6
Capital formation	-24.9	-20.1	-13.0	12.8	9.0	16.5	19.7	21.7	14.2	6.1	2.7
Export	13.7	4.1	-2.6	-1.1	18.3	16.7	9.7	12.2	14.3	-2.6	na
Import	-17.9	37.8	13.9	18.5	13.4	20.5	28.0	21.4	18.5	1.0	na

Source: GUS, *Rocznik Statystyczny*.

1. A variety of exchange rate regimes in Central-Eastern European countries in transition

Before proceeding to investigate the exchange rate policy in Poland, it is convenient to have a perspective on exchange rate regimes in Central- Eastern Europe.

Over the past more than 10 years, transition economies in Central-Eastern Europe have displayed a wide spectrum of exchange rate regimes, ranging from a rigidly controlled fixed exchange rate regime to a freely floating one. In between there have been a currency board system, a fixed peg regime, a regime with adjustable peg and band, a pre-announced crawling system and an independent floating rate regime (see Table 2). Such diversity has its roots not only in differences in initial conditions at the beginning of transition, but has also been caused by a good few regime changes in the course of transition. In many countries, exchange rate regime has been frequently modified and occasionally replaced due to economic institutional evolution and changes in the economic situation.

Embarking on transition from the socialist planned economy, these countries were confronted by several pressing problems related to foreign exchange rate policy. One problem lies in the selection of an exchange rate regime. Another problem is how to set the initial exchange rate. To which extent convertibility is endowed is also a key issue. Answers to the problems were given differently, reflecting different initial conditions of each country, such as foreign currency reserves, development of inflation, macro economic imbalance, amount of monetary overhang and so on. Already at the beginning, therefore, exchange rate policies in Central-Eastern Europe were varied.

Table 2. Exchange Rate Regimes in Central-Eastern Europe1in 1990-1997

Country	Regime	Currency convertibility
Albania	Managed Float since July 1992	Current account: mostly free Capital account: inflows mostly free, outflows restricted
Bulgaria	Managed Float, Feb. 1991-July 1997 Currency Board Since July 1997	Current account: mostly free Capital account: inflows mostly free, outflows restricted
Croatia	Fixed: Dec.1991-March 1992 Expected PPP Crawl: March 1992-Oct. 1993 Managed float since Oct. 1993	Current account: mostly free Capital account: mostly free inflows and outflows
Czech Republic	Fixed: Dec. 1990-May 1997 Managed float since May 1997	Current account: mostly free Capital account: inflow mostly free, outflows restricted
Hungary	Adjustable peg since before 1989 Preannounced crawling band since March 1995	Current account: mostly free Capital account: inflow mostly free, outflows restricted
Macedonia	Managed Float since April 1992	Current account: mostly free Capital account: restricted
Poland	Fixed, Jan. 1990-Oct. 1991 Crawling peg since then	Current account: mostly free Capital account: restricted (inflows and outflows)
Romania	Managed Float since Aug. 1992 Unified rate since July 1997	Current account: mostly free Capital account: mostly free (inflows and outflows)
Slovak Republic	Fixed since Dec. 1990 with frequent depreciation	Current account: mostly free Capital account: restricted
Slovenia	Managed Float since Oct.1991	Current account: mostly free Capital account: mostly free

Source: Wyplosz 1999.

Regarding the choice of foreign exchange rate regime, I would like to point out that only two countries, Poland and Czechoslovakia, applied a fixed exchange rate regime in the early stage of transition, following the suggestion of IMF. The others did not, despite IMF recommendation and its strong influence.[2]

[2] "Poland, Hungary [sic] and Czechoslovakia accepted the suggestion of IMF that a fixed rate

2. Reforms before the Balcerowicz program and its introduction

In Poland, under the socialist regime, economic reforms had been attempted several times. The latest was attempted at the beginning of 1989. Being faced with political and economic hardships, the last government of the socialist regime introduced a radical economic reform program. Undoubtedly this program made it possible for the team led by Leszek Balcerowicz to start their reform not from scratch.

For the most part, however, reform attempts by the socialist government have been ignored after 1990. It is very rare to mention effects of preceding reforms in the literature on the transition economy of Poland, although it is so often that the negative legacies of the socialist regime are referred to.

The time of socialism seems to be treated as an *ancien regime* to which positive aspect is no attributable. It is like saying that you could jump well and win without a good runway. As a matter of fact, when it comes to foreign exchange rate policy, the former socialist government got down to reforms of the system and paved the way for a key instrument of the Balcerowicz program.

2.1 The pre-history of the "Big Bang"

Taking a longer view than the ten-year transition period, we may get a better perspective of the transition economy in Poland. We recognize easily that the roots of the Balcerowicz reform date back to the reforms in the 1980s.

In 1982, under martial law, reform of the economic system was started. A modification of the planning system was intended in order to make the best of a market mechanism. Many prices were set free and state owned enterprises (SOEs) were given greater autonomy. In theory, a stage was set, and actors prepared for the working of a market mechanism. It is worth noticing that the law of SOEs of 1981 provides the groundwork for autonomy of SOEs and article 19, describing a procedure of liquidation of SOEs, is put to practical use as one of main privatization measures at the present time.

In the late 1980s reforms were continued. The monopolistic banking system was loosened and more or less equal conditions for SOEs, cooperatives and private firms were created. A price-income adjustment was introduced. Some transfer of public assets to private interests was permitted and a so-called "spontaneous privatization" was begun.

Towards the end of 1980s prices increased and wages were raised accordingly. Consequently, general shortages of consumer goods occurred. The black market thrived and strike waves broke out.

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regime should be applied as "a nominal anchor" for an internal stability. Other countries selected different floating system, not because they were not convinced of its superiority, but because they realized that a fixed rate regime could not be sustained on account of limited foreign reserves and less confidence in stabilization policies."(Rosati 1998, pp.225-226, tr. by H.W.)

At the beginning of 1989, the Rakowski government introduced a reform program containing following actions,

- liberalization of foreign exchange operations: through a new foreign exchange law in force in April private foreign exchange transactions among residents were legalized and licensed exchange offices opened,
- arrangement of legal equal conditions for economic activities regardless of a property form: a new law on entrepreneurship provided a common juridical base for all enterprises and opened ways for the privatization of SOEs,
- reduction of subsidies on a large number of consumer products, especially on food,
- closure of inefficient plants and those particularly harmful to the environment,
- introduction of incentives for foreign investors.

Obviously, these changes of the economic system were the antecedent to the reforms in 1990s. But, on the other hand, a series of measures adopted in the late 1980s prepared the stage for an inflationary spiral. In fact the flame of three-digit hyperinflation in the second part of 1989 was ignited by the decision to liberalize the prices of food products in August.

2.2 Policy measures of the Balcerowicz program

What is commonly called the Balcerowicz program is not a single document but consists rather of three different documents: The Government's Program of the Reconstruction of the Economy,[3] which was published in October 1989, and two Letters of Intent to the IMF.[4]

Immediately after being appointed as Vice Prime Minister and Minister of Finance, Leszek Balcerowicz attended an annual assembly of IMF in September and submitted a Letter of Intent making commitments to an economic reform. Second one was the approved economic policy by the Sejm in December which was put forward as basis for stand-by credit negotiations.[5]

The reform program consists of two major pillars:

- a stabilization policy package to deal with a hyperinflation,
- a structural reform through liberalization and institutional change.

The stabilization package comprises four main policy measures: fiscal, monetary, foreign exchange rate and tax-based incomes policy. Concerning fiscal

[3] In this document the initial conditions of the "Big Bang" were described as follows; "We are embarking on the reshaping effort under extremely adverse conditions. The economy is in ever more tenuous disequilibrium, on the verge of financial collapse of the state. …. In recent months additional crisis symptoms surfaced or mounted in force: rapid price climb linked with wage explosion, the flight from the zloty, growing deficit of the state budget and also a drop in output…."

[4] M.Dabrowski 1995, pp. 10-11.

[5] L.Balcerowicz 1992, pp. 37-39.

policy, the target was set to reduce the state budget deficit to less than one per cent of GDP in 1990, from 8 per cent in 1989. A substantial cut in subsidies was the main means to achieve this goal. As for monetary policy, the excessive demand was to be contained through restrictions on money supply. The interest rate was to be used as the main monetary policy instrument. By raising the interest rate to positive real levels, a shift from foreign currency deposits to zloty financial assets was induced.

On January 1, 1990, the unified rate for foreign exchange was set at 9,500 zloty against the dollar, and internal convertibility was introduced. International supports such as a stabilization fund (1 bn US$) raised by some G-24 countries and a bridging loan from the Bank of International Settlements (215 mil US$) were arranged to strengthen confidence in the sustainability of the rate. In the field of tax-based incomes policy, a 200 to 500% tax, known popularly as "POPIWEK", was introduced on wage increases exceeding the predetermined indexation coefficients linked to inflation.[6]

3. The exchange rate policy and the development of the transition economy in Poland

Now that we have seen the runway and the introduction of the Balcerowicz program, we move to the transition period. First we take a quick look at the evolution of an exchange rate regime in the transition period. Then, in the light of the evolution, we review the economic development in Poland after 1990.

3.1 The evolution of exchange rate policies in Poland

Table 3 shows the evolution of exchange rate policies in Poland. We observe that the exchange regime has been changed several times and frequently been adjusted. Yet, we can recognize four different types of exchange rate regimes applied since 1990. Those are a fixed rate regime, a crawling peg regime, a crawling band regime and a direct inflation target regime.

Their characteristics are as follows:

The fixed rate regime (Jan. 1990-Oct. 1991)

As already mentioned, on January 1 1990 zloty was devaluated by 43%. This deep devaluation raised exports and reduced imports, which led to a surplus in 1990. At the same time it, undoubtedly, became a great inflationary factor. In 1990 CPI increased by 250% and GDP fell by 12%. As inflation increased under a fixed nominal rate, the real rate of the zloty appreciated quickly. Imports surpassed exports toward the end of 1990.

The crawling peg regime (Oct. 1991-May 1995)

From the 4th quarter of 1990, the current account deficit grew rapidly. In May 1991 the monetary authorities were forced to devaluate by 17%, and in Octo-

[6] The permitted wage increase in SOEs was 30 per cent of the inflation rate in January, 20 per cent in February to April and 60 per cent from May on.

ber they took the decision to abandon the fixed rate regime and to introduce a crawling peg with a narrow band. This decision was aimed both at curbing inflation and at dealing with current account imbalance. The "exit policy" from the fixed rate regime was implemented without big turbulence due to administrative limitations on capital flow.

Table 3. Polish Exchange Rate Regimes since January 1990

Date	Regime
Jan-90	Devaluation by 42% and Fixed rate to US$
May-91	Devaluation by 17% and Basket of 5 currencies introduced
Oct-91	Crawling of 1.8% per month
Feb-92	Devaluation by 12%
Oct-92	Crawling band introduced +-1% per month
Aug-93	Devaluation by 8% and Crawling of 1.6% per month
Sep-94	Crawling of 1.5% per month
Nov-94	Crawling of 1.4% per month
Feb-95	Crawling of 1.2% per month
Mar-95	Band widened +-2%
May-95	Band widened +-7%
Dec-95	Revaluation by 6%
Jan-96	Crawling of 1.0% per month
Feb-98	Crawling of 0.8% per month and Band widened +-10%
Jul-98	Crawling of 0.65% per month
Sep-98	Crawling of 0.5% per month
Oct-98	Band widened +-12.5%
Jan-99	Basket changed to 2 currencies
Mar-99	Crawling of 0.3% per month

Source: NBP, *Raport Roczny*.

The crawling band regime (May 1995- the beginning of 1999)

In May 1995 the crawling peg was replaced by a crawling band regime. The band crawled with a pre-announced monthly devaluation, which was gradually diminishing. In terms of capital inflows, the situation changed dramatically in the first part of 1995. Following agreements with the Paris Club and the London Club creditors in 1994, Poland could normalize relations with international financial communities, after 15 years of break. The investment risk in Poland was reduced and restrictions on capital flow relaxed. Foreign capital flew rapidly into Poland. The National Bank of Poland (NBP) was obliged to deal with a sudden massive inflow of foreign capital. Pressure for appreciation of the zloty was intense. The Central Bank tried to buy large amounts of foreign currencies. After using up its resources, the NBP resolved to widen the fluctuation band from (+/-) 2% to (+/-) 7% in May 1995 and further revalued zloty by 6% in December 1995. In this year

the official foreign reserves increased from 5.8 bn $ to 15 bn $, supposedly due to the defense of the exchange rate against upward pressure.[7]

The direct inflation target regime (1999-

In 1998 the NBP gradually refrained from intervening the foreign exchange market. It widened the band to (+/-) 10% in February 1998 and again to (+/-) 12.5% in October 1998. At the beginning of 1999 the direct inflation target regime was adopted and the Bank expressed an intention to halt the crawling system and move to free float regime. This policy continued in the Medium Term Monetary Policy Strategy for the years 1999-2003, accordingly in the Monetary Policy Guideline for the year 2000. In April 2000 the council of ministers took the decision to float the zloty.[8]

3.2 Development of the transition economy

From the perspective of a decade, we can distinguish several phases of development of the Polish transition economy. I think it is uncontroversial to divide it into four phases in terms of GDP growth trend as follows;

Phase 1: cave-in[9] (1990-1991)
Phase 2: recovery (1992-1994)
Phase 3: acceleration (1995-1998)
Phase 4: slow down (1999-

It is worth paying attention to the fact that these phases almost overlap the

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[7] I think that the year 1995 as well as 1990 was a critical turning point of the exchange rate policy in Poland. As the ratings of Poland picked up, foreign investors sought profitable objects in Poland. In the 3rd quarter of 1994 yields on 3-month Treasury Bill hovered around 27-28%. Due to a steady devaluation (1.4% per month), annual devaluation was expected to be about 18%. Foreign capital rushed into the Treasury bond market. Being faced with a new situation, monetary policy got confused. First the NBP, which considered that an increase of foreign reserve was potentially an inflationary factor, reduced the rate of crawl in February 1995 to 1.2% and two weeks later raised interest rates by 2-3%. Consequently the inflow of foreign capital was accelerated because of the widened interest disparity. For the first four months of 1995 official foreign exchange reserves increased by 5 bn $ and only in April net inflow amounted to 1.5 bn $. Under the upward pressure, continuing sterilization operation at the rate would make the central bank suffer large losses shortly. In May the NBP took a decision to widen the band to (+/-) 7% in order to let the exchange rate adjust more freely. In addition, in June interest rate was lowered by 4%. However, after a slowdown of capital inflow, foreign investors continued to buy the bills more intensively. In December 1995 the bank finally resolved to revalue zloty by 6%. Furthermore, the Bank reportedly lost around 1 bn $ through sterilization operation in 1995. The fiasco of the NBP in 1995 was because it tried to control at the same time three variables, exchange rate, interest rates and inflation target. (Rosati 1998, pp. 174-189)

[8] NBP, *Raport Roczny 2000*, pp. 38-40.

[9] In the Polish literature on the transition economy, the term "recession" has been widely used to describe the sharp shrink of the economy at the beginning of 1990s. However it is not a proper term to indicate a big fall equal to *the great Depression*. Taking into consideration the discontinuity and vacuum of system, I propose to use a new term "cave-in".

periods of the exchange regime type.

Phase 1

Roughly speaking, the cave-in at the beginning of 1990s was caused by the introduction of the reform program, the stability package and the collapse of COMECON. During two years GDP decreased by 18% and real wages fell sharply by 30%.

The team of Balcerowicz supposedly expected that decision makers at the enterprise level would react quickly and adjust to the new situation. They must have thought that clear economic signals would start to work and actors of the new economic play would perform their roles. However, in spite of their play-book the main actors, managers of SOEs took a "wait and see" attitude. I think that it was quite a natural attitude. As well as being uncertain about the future and lacking know-how to deal with a new situation, they were not urged to perform their roles on account of good economic conditions.

Unexpectedly the SOE sector recorded fairly good profit in the first of 1990. They found themselves in favorable financial situation through:

- unexpected increase of accumulated asset values as a result of hyperinflation,[10]
- a surge of the value of foreign currency deposits due to the deep devaluation,
- lowering labor cost thanks to "POPIWEK",
- manipulation of cutting output and raising price,
- increasing values of assets because of continued inflation.[11]

Contrary to the declared intention of the Balcerowicz program, the SOEs were "not shocked". If anything, the SOEs were afforded quite some time to be prepared.

In 1991, however, the financial situation of many SOEs deteriorated rapidly. The collapse of COMECON severely hit the Polish industry. It led to a crisis in all the former COMECON countries and Finland. The change of financial situation forced a number of SOE managers to change their attitudes and become businessmen rather than insatiable negotiators of a socialist economy.

Phase 2

At the middle of 1992 output of the manufacturing industry sector showed signs of recovery. Other industry such as transportation and construction followed. However, the force of the recovery appeared rather fragile. As it was, investment still stagnated.

With uncertainty about the future, in particular concern about privatization being weakened, the trade between SOEs in excess of assets such as machinery, buildings, lands, labors, know-how, financial means and so on became thriving.

[10] Due to hyperinflation in 1989, booking prices of inventories turned out tremendously low.

[11] Net turnover profitability rates of the industry sector as a whole fluctuated from 43.5% (1989), 30.9% (1990), -3.7% (1991) to 1.6% (1992). GUS, *Rocznik Statystyczny*.

Unintentionally they reallocated existing resources. A large number of SOEs improved their production facilities and began adjusting to real demands.

In 1993, the socialist government, which was more flexible in terms of privatization, was established. Not in earnest being urged to privatize, able SOE managers began making up restructuring plans, which situation brought about a steady increase of investment. A growing tendency of economy became more than visible.

Phase 3

In the middle of the 1990s the economic growth was accelerated. GDP grew in the range of 6-7% annually during 1995-1998. Investment dramatically expanded at rates surpassing 10%. After resuming relations with the international financial community, FDI started advancing in Poland. Inflation slowed down and unemployment decreased. Consumers' expectation was enhanced and consumption grew.

However, these favorable trends were overshadowed by a growing trade deficit. Although the current account was mitigated by a large inflow of foreign currency from cross border trades, the deficit on the current account amounted to about 4% of GDP in 1996.

Phase 4

In the second part of 1998 the economic growth began to decelerate. The GDP growth rate fell from 4.8% in 1998 to 4.0% in 1999. Undoubtedly, monetary upheaval in Russia affected the Polish economy largely on account of the fall of its export markets in the former Soviet Union. However the shock from Russia was apparently absorbed in 1999.

The deceleration trend ought to be attributed to the lack of consistency in the policy mix – fiscal, monetary and exchange rate policy. It is rather an inherent dilemma in this stage of transformation. If it is necessary to cool down an overheat and prevent from widening a current account deficit, theoretically, raising interests is an effective measure. But it would cause pressure of appreciation of the currency through the increased inflow of portfolio investment, following which there would be a growth deficit of trade balance. In this stage, trade balance could not be improved by exchange rate policy. Fiscal policy should be conducted more cautiously.[12]

In order to keep up the competitiveness of the Polish economy, another economic policies such as FDI attracting policy, export policy, S&M enterprises policy ought to be utilized more than before. Above all, it is needed that SOEs should be transformed into more competitive ones. It is time that the economy should be

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[12] Inflation tendency continues in this stage of transition because of budget deficit and differences of productivity growth. Demand for public investment is far from being satisfied and expenditure is under strong pressure of expanding. Differences in productivity of FDI advanced industries and others cause inflation, which is known as Balassa-Samuelson effect. (Gotz-Kozierkiewicz 2001, pp. 41-57)

"przekuwanie" (reforged). Privatization needs to be thought of as a policy instrument to restructure the economy.

Table 4. Selected economic indicators

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP/capital (US$ at exchange rate)	1547	1999	2198	2232	2402	3086	3484	3725	4098	4011	4082
Consumer prices, %p.a.	585.8	70.3	43.0	35.3	32.2	27.8	19.9	14.9	11.8	7.3	10.1
Producer prices, %p.a.	622.4	48.1	28.5	31.9	25.3	25.4	12.4	12.2	7.3	5.7	7.8
Real growth wages rates, %p.a.	-24.4	-0.3	-2.7	-3.9	0.5	3.0	5.7	6.8	4.5	4.7	2.6
Retail trade growth rates, %p.a.	-17.4	3.8	7.9	6.9	3.0	2.3	4.5	6.8	2.6	4.0	1.4
Money supply (M2), tri. zloty	19.1	26.1	41.1	55.9	77.3	104.3	136.7	176.4	220.8	263.8	294.4
Discount rate, %p.a., end of year	48.0	36.0	32.0	29.0	28.0	25.0	22.0	24.5	18.3	19.0	21.5
Deficit of central gov. budget, % of GDP	0.4	-3.8	-6.0	-2.8	-2.9	-2.6	-2.5	-1.4	-2.4	-2.0	-2.2
Unemployment rate, %, end of year	6.3	11.8	13.6	16.4	16.0	14.9	13.2	10.5	10.4	13.0	15.0
Exchange rate per US$, average (1)	9500	10582	13631	18145	2.27	2.42	2.70	3.28	3.49	3.97	4.35
Current account, mil. US$	716	-1359	-269	-2329	-944	5455	-1352	-4268	-6858	-11660	-9946
Foreign debt, mil. US$	48500	48400	47000	47200	42174	43957	47354	49648	59163	64890	68193
Foreign reserve, mil. US$	4680	3814	4287	4281	6029	14963	18033	20670	27210	26107	26321

(1) In 1994 downward redenomination by four figures.
Source: GUS, *Rocznik Statystyczny*.

Table 5. Balance of payments (mil. US$)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Current account	716	-1359	-269	-2329	-944	-2299	-1352	-4268	-6858	-11660	-9946
Trade balance	2214	51	512	-2293	-836	-1827	-8154	-11269	-13720	-14462	-13168
Export	10863	12760	13997	13585	16950	22878	24420	27229	28229	26386	28256
Import	8649	12709	13485	15878	17786	24705	32574	38498	47054	40848	41424
Services, net	-150	236	344	369	57	150	-209	305	-508	-1623	-1684
Income, net	-3329	-2863	-4054	-3424	-2081	-628	-366	-465	-568	-800	-761
Current transfer, net	1981	1217	2929	3019	1916	6	224	1100	1942	1589	1680
Capital and financial account											
Direct investment	10	117	284	580	542	1134	2741	3041	4966	6348	6967
Portfolio investment				0	-624	1171	241	2098	1330	866	2587
Other investment	-6664	-5427	-1723	175	1958	454	1715	2355	4431	404	-3386

Source: GUS, *Rocznik Statystyczny*.

Conclusion: Once again 'shock therapy' or gradualism?

Let us summarize the main points that have been made until now.

1. In contrast to common perceptions of the initial conditions we can point out another aspect. As for SOEs, the hyperinflation brought about a tremendous increase of value of assets and gave relief at the starting of transition.

2. The fixed rate of 9,500 zloty was extremely undervalued.[13] It could not be

[13] The setting of an initial rate at 9,500 zl against US$ at the beginning of 1990 is still under

a nominal anchor. If anything, it was a strong inflationary factor.

3. Some measures of the Balcerowicz program improved financial conditions of SOEs to absorb shocks of the economic system changes. Against the goals of the program, surviving SOEs lost momentum of privatization. Sweeping collapse and liquidation of production units, which occurred in the name of privatization in many other transition countries, was avoided. This situation made possible an earlier recovery of the Polish economy.

4. Moving adjustable peg regime from a fixed exchange rate in 1991 is a unique and successful "exit policy" among the transition economies.

5. Crawling in the direction of devaluation proved to be effective in the early part of transition.

6. The role of exchange rate policy has changed in accordance with the development of the transition economy in Poland.

7. Nearing an accession to the EU and applying a free float rate regime, other economic policies should be more utilized than before. It is time that privatization should be considered in earnest.

I close this paper putting forward a working hypothesis, a little bit different from the received wisdom or myth.

Hypothesis:

- The Balcerowicz program was not "shock therapy" from the economic point of view. The reform had started earlier, and SOEs were afforded some time to adjust to the new situation.

- The exchange rate policy at the beginning of 1990 encouraged characteristics of the Polish transition economy, i.e., favorable economic performance and persistent dominant existence of gigantic state owned enterprises.[14]

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debate. Rosati points out that the rate was 'overshot'. "All measures of the stabilization package caused bigger decrease of the aggregated demand than assumed. In addition, the supply contracted largely through raising interest rates and limiting credits,… Excessive devaluation of zloty did severe damage to the recession. It is difficult to understand why did the rate at 9500 zl/dol. was applied, not the black market rate at around 8,000 zl/dol…"(Rosati 1998, pp. 50, tr. by H.W.). Kolodko acutely claims that the rate was "grossly undervalued". "The instant convertibility decreed in January 1990 could only be achieved a grossly undervalued exchange rate – with respect to Purchasing Power Parity (with the US dollar at almost twenty times the PPP rate at the beginning of January 1990)…"(Kolodko, Nuti 1997, pp. 12-13). It is a fact that the rate was set extremely low and caused unexpected effects. In addition to it, I think, there is still another question to be explained. Why such a sharp devaluation was possible? Why did the team of Balcerowicz settle that low rate? Why could it be accepted in the Polish society?

[14] A usual argument is that a delay of privatization in Poland could be attributed to the political influence of strong trade union and unpopularity of the society caused by devious "spontaneous privatization" of *nomenklatura* in the second part of 1980s. It can explain retained SOEs, but not their economic revival. In the industry sector 1,458 SOEs operate, employ 673,300 workers and produce 21% of its total output as of 2000. GUS, *Rocznik*

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