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How To Help The Solidarity Government Succeed; Aid For Poland

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At the time of the Paris Summit last July, the western governments began to chart a strategy of modest economic aid to Poland based on three premises that quickly proved to be wrong: that Solidarity would remain in opposition; that economic reforms would proceed gradually and piecemeal under a Communist-led government; and that the Polish economy would remain sick but still manageable.

During the past two months, the situation has changed fundamentally. Solidarity has now formed the first non-Communist government in Eastern Europe, and Prime Minister Tadeusz Mazowiecki's cabinet has made clear its intention of creating a western-style market economy operating within a parliamentary democracy. At the same time, there has been a startling economic deterioration, with the outbreak of hyperinflation and the collapse of supplies in vital consumer goods markets.

The West must now create a new strategy of financial assistance. The previous plans for food aid and for some project lending are still useful, but are of limited significance. With Mr Mazowiecki's government battling for survival, aid from the West should aim to support the new government's efforts to end the hyperinflation and regain financial stability.

At this week's annual meetings of the IMF and World Bank, Leszek Balcerowicz, Poland's new Economy Minister, is circulating a timetable that outlines the harrowing tasks ahead. The timetable calls for a broad set of measures in the next two years to tame the hyperinflation, restore price stability, build Poland's private sector and put the sprawling government sector under market discipline.

The measures planned over the next six months are fraught with the greatest peril. Subsidies are to be cut sharply, prices are to be liberated from decades of arbitrary administrative controls, and the highly overvalued exchange rate is to be devalued, unified and made convertible. These changes will produce a "corrective" inflation on top of the existing rate of 50 per cent a month, but are necessary to eliminate the enormous budget deficit and to provide a realistic price structure in which the private sector can begin to function effectively.

After these corrective steps, there will be the chance early in 1990 to bring about a shift to price stability. As in the recent experiences of Bolivia, Mexico, Israel, and now Argentina, the government will be in a position to offer workers a stable, unified exchange rate and stable prices for key commodities (with prices tied to world levels), in return for a period of wage restraint. But the bargain will be hard to sell, since real wages will have been sharply reduced by the subsidy cuts.

The government will also carry out a series of crucial institutional reforms, to begin almost immediately. A new privatisation law will be introduced by the end of this year, with the aim of transforming much of Poland's state sector (which now accounts for more than 90 per cent of industrial production) into joint-stock companies owned by Poles and foreign investors. The government plans to tackle fundamental tax reform in 1990, to correct a tax system that is bewildering, arbitrary and punitive, with marginal tax rates that rise close to 100 per cent.

These reforms can end a situation in which skilled workers in the centre of Europe earn just Dollars 30 per month because the system arbitrarily kills efficient economic activity. With overvalued exchange rates and confiscatory taxes, it is no surprise Poland's recent export push has taken the shape of a flood of Polish workers moonlighting in the West and carrying goods in their cars for sale on the streets of West Berlin. Poland's chances of economic growth in the medium term are excellent, assuming that prices, the budget, and the ownership and tax systems can be rationalised as planned.

The West can play a vital role in fostering this transition by a rapid and well-directed programme of financial support. Two kinds of actions are of over-arching importance. The first is a rapid infusion of foreign exchange to support the Government's efforts to stabilise the currency, and thereby break the hyperinflation. The second is extensive debt reduction, to remove the Dollars 39 bn overhang of financial liabilities that will otherwise cripple Poland's chances for a fresh start.

Within the next 90 days, the West should support the following steps.

The IMF should extend a one-year standby credit to Poland of around Dollars 700 m (90 per cent of Poland's quota in the IMF).

The World Bank should extend a Dollars 500 m Structural Adjustment Loan to support the fundamental transformation of the economy. Both loans would be conditional on the policy changes the Polish authorities have already outlined.

Most critically, the West should provide an immediate boost to Poland's depleted foreign exchange reserves through a stabilisation loan of at least Dollars 1 bn, constituting about two months of Poland's imports from the West. The money from the IMF and World Bank is too small and will be disbursed too slowly to offer a substantial boost to foreign reserves which have fallen to just two weeks of imports. History has shown repeatedly that a stabilisation loan can greatly improve the chances for defeating a hyperinflation. By raising the prospects for a stable currency, the loan brightens the chances for wage restraint, and weakens the internal political opposition to fundamental reforms.

The western governments should also recognise that Poland's debt is now completely unserviceable for the next twelve months, and is substantially unpayable in the longer term. Therefore,

The Paris Club of Poland's government creditors should simply refinance all debt service falling due in 1989 and 1990, and capitalise late payments from 1988. The commercial banks should similarly finance the interest due over the next year. After the dire emergency abates in 1990, the Government of Poland could start discussions with the Paris Club and the banks to achieve a long-lasting reduction, by about one half, of the debt burden.

The financial assistance that Poland needs is a pittance for the West. A Dollars 1 bn stabilisation loan could easily be arranged in a morning through the swap networks of the central banks and finance ministries. The IMF and world Bank loans could be in place in 45 days. The package of debt reduction measures would merely make explicit what is already obvious in practice.

The stakes in Poland are enormous, not only for the Poles, but for the whole world. Success will point the way for peaceful economic reforms and democratisation in the rest of Eastern Europe and the Soviet Union. Failure, especially if it provokes a new clamp-down in Poland, could poison the chances for reform for years to come, and throw Europe back into the bitter days of the cold war.

If Poland's government fails for lack of adequate western support, our greatest loss would be spiritual. The West would be forced to confront for years to come a failure of will to act on behalf of the greatest western ideals of freedom and democracy.

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