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Poland's Economic Performance in Global and Long-term Perspective: Surprises so far and Risks in the Years Ahead

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Abstract: The paper is focused on economic and institutional developments in Poland during the last 30 years of transition from its centrally planned socialist economy to a market-based capitalist economy. The main purposes of the paper are three. One is to identify and explain the developments that were either surprising or specifically Polish. The second purpose is to note and explain the differences between the rate of growth of the Polish economy and that of the other emerging economies, in particular to explain 'the green island' phenomenon during the global financial crisis 2008-2009. The third purpose is to note and discuss the new risks that may prevent Poland to reduce further the development gap to technologically most advanced economies.

Keywords: transition economies, Poland's performance surprises, global growth trends, Polish policy risks

JEL Codes: P16, P27, P51

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1 Introduction

Much of this paper are comments on, and interpretations of, the institutional reforms during the last few decades in the formerly centrally planned economies, especially in Poland.

Major Institutional changes started in China in the years 1978–1980, to be followed by similarly large changes in the countries of Central Europe and the former USSR in the years 1989–1991, Their revolutionary economic and social systems, based on central management, state ownership, and dominant role of central preferences, then started to be replaced by the original ones, based on individual entrepreneurship and preferences, market competition and private ownership.

In this way, the biggest institutional experiment of the 20th century, which tested in practice the theories underlying two globally competing systems - market capitalism and state socialism - came to an end.

This 20th century global economic and social experiment tested in particular two key ideas, one due to Karl Marx and the other to Joseph Schumpeter. Elsewhere I commented on these ideas in the following way (Gomulka, 1990):

"Both Marx and Schumpeter argued that capitalism would give way to socialism. Although their arguments were quite different, they rested on assumptions concerning the innovation process and its effects. Innovations have been largely labour saving, as Marx assumed, but, contrary to his expectations, they have not caused the increasing and eventually massive unemployment which was supposed to lead to a super- economic crisis and, eventually, to the overthrow of the capitalist system… Marx clearly underestimated, or simply overlooked, the positive effect of innovations on (average) wage increases and, in turn, the positive effect of increasing (average) wages on the (aggregate) demand for goods and the (total) employment of labour.

For Schumpeter the truly capitalist economic system was one in which the individual initiative of the entrepreneur, rather than the collective efforts of organizations, was central to insure success. However, his economies-of-scale argument led Schumpeter to believe that small firms, in their inventive and innovative activity, would be at a disadvantage compared with large firms, and so the latter would eventually dominate. In his theory firms would eventually be so large and complex that they have to be run by hierarchical organizations. A bureaucratized economic system would emerge, which in his words would be 'an order of things which it will be merely a matter of taste and terminology to call Socialism or not' (Schumpeter, 1928). He argued, therefore, that such a system could in due course become less innovative than the initial entrepreneurial capitalist system".

As we know by now, Schumpeter was wrong in his prediction of the diminishing, eventually marginal, role of small and medium sized firms under a capitalist system. But he was correct in his characterization of economies under a socialist system as far more bureaucratic and much less innovative than those under a capitalist system.

In China, the biggest impulse to change substantially, and perhaps even to abandon, the state socialist economic system was provided by the political and economic crisis in the 1970s. That crisis resulted in the dissolution of communes in 1979, followed by gradual marketization and privatization. In Central Europe, the initial impulse to radical reforms was provided by the economic and political crises in Poland in the 1980s, which resulted in the adoption of a democratic and fully capitalist economic system in the 1990s. In the USSR, doubts about the quality of the socialist system were ignited by the post-1975 growth slowdown. Nevertheless, resistance to market-oriented reforms was strong until late 1980s. The start of the transformation in late 1991 reflected the final and widespread acceptance by its communist elites of the results of the global experiment in economic system.

The key long term economic purpose of the transition in all formerly socialist countries has been to reduce substantially, perhaps even to eliminate completely, the "civilization gap", and more specifically the per capita income and wealth gaps, vis-a-vie western Europe and the United States.

With respect to the transformation in Poland,[2] I propose to divide the economic developments since 1989 into two groups, those largely typical for countries in transition, and those which have been rather specifically Polish, some of them unexpected. The purpose in the first part of my paper is to list and discuss these two classes of developments. The purpose in the second

2 The literature on Polish transformation is too extensive to be reviewed. But I should note that there are three large volumes of government documents, all in their original languages, on internal policy discussions, the IMF advice, key new laws and policy decisions, and debt reduction negotiations, published by SCHOLAR: vol. I, 2010, with reference largly to 1989, edited by T. Kowalik, vol. II, 2011, with reference to 1990, edited by S. Gomułka and T. Kowalik, and vol. III, 2013, with reference largly to 1991–1993, edited by S. Gomułka. Volume I is available both in paper and electronic versions, and volumes II and III are accessable on the ResearchGate. Included in the volumes are also my 25 journal articles on varies aspects of the Polish transformation.

part is to list and discuss the risks that are present now and likely to remain in the years ahead which, if they come about, will slowdown the catching up process and may keep Poland significantly and permanently behind western Europe.

2 Developments in Poland that were typical and expected in transition countries

A key initial development in all transition countries was price liberalization. A fast introduction of market prices at the start of transition eliminated quickly, within about three months, shortages and queues. This development in Poland produced the first important social improvement in the early 1990.

This particular success disproved the theory, developed by Janos Kornai, that the necessary condition for the elimination of shortages is an earlier imposition of hard budget constraints on enterprises, and that such imposition would require privatization of state enterprises. I questioned that theory before the transition started. A debate took place between Kornai and myself concerning that theory on the pages of the journal *Economics of Planning,* October 1985.

Price liberalization and elimination of most product specific price distortions also resulted, in almost all countries in transition, in exceptionally large changes in relative prices, causing deep and fast changes in the composition of the domestic demand. Given the restricted mobility of labour and other resources, and a dramatic reorientation in foreign trade, large falls of outputs of many industrial products in the initial period of transition became inevitable. So the second important initial development was the so-called transformational recession (Kornai 1994, Gomulka and Lane, 2001). This recession produced a large social cost in most transition countries, in the form of high unemployment and islands of poverty, over a prolonged period.

The third important and almost common development was a supply- side defensive response by old and new firms, initially in the form of lower production of some products, followed by the introduction of less costly methods of production and new or improved products. These responses led eventually to an increase in the rate of growth of per capita GDP, substantial enough to resume the process of catching up with the per capita GDP levels of the technologically advanced economies.

3 The unexpected developments in Poland

During the last 25 years the rate of growth of per capita GDP in Poland was about twice as high as in the part of the world economy which I call the Technology Frontier Area (TFA). The TFA includes, above all, western Europe, the USA and Japan. As a result of this much better growth performance, despite the costly transformational recession in the years 1990–1991, the level of per capita GDP (PPP) in Poland increased, according to the IMF, from 30,1% of the US level in 1989 to 49,6% in 2017. Compared to Germany, the increase was from 35,7 % in 1989 to 58,5% in 2017 (in 1989 without eastern Germany). Such a large and relatively fast improvement in this aggregate measure of the relative level of development was indeed hoped for, even expected.

However, in the process of this overall large improvement several developments in Poland were unexpected.

1. The transformational recession in Poland was smaller in size and shorter in length than in nearly all other European and the USSR countries in transition. Given the exceptionally deep financial crisis in 1989, this was a surprise. The subsequent growth of the per capita GDP has been in Poland fairly fast among the countries of Central Europe and the former USSR, but moderately fast among all countries outside the TFA, and much slower than that in China.
2. The expansion of output and employment in the new private sector was exceptionally fast in the first few years of transition, with an annual rate in the range of 20–30 %. This development was a surprise as the expansion was much faster than in any other country undergoing transformation. …. My explanation of this surprise is based on data showing a large inflow from abroad of many Polish workers and their significant savings in the initial phase of transformation.Due to some economic liberalization before 1990, much larger than elsewhere in Eastern Europe, the number of such workers was also exceptionally large. Apparently the economic and political program of the first post-communist government of Tadeusz Mazowiecki, with Leszek

Balcerowicz its key policy maker in the economic area, was sufficiently convincing for the Poles with entrepreneurial talent to invest their savings in new businesses in Poland.

3. Poland and Bulgaria were the only countries in transition which were offered large (by 50%) foreign debt reductions by western governments and private banks. But only in Poland did the initially small foreign reserves start to increase very early and fast. That development was also a surprise; This particular surprise has the same explanation as that of surprise no 2.
4. There has been no significant crisis in the financial sector, and so there was never, not even during the world financial crisis 2008–2009, any need to use significant public resources to capitalize banks and other financial institutions (a recapitalization of some banks in the early 1990s was relatively small). In order to win the 50% foreign debt reduction, Poland needed the support of the IMF. This gave that institution a significant role in the conduct of macroeconomic policy in the first few years of transformation[3] That enhanced role helped the minister of finance and the governor of the central bank to win the parliamentary support for a more sensible financial policy in those years.
5. Social transfers in the first fifteen years of transition, at levels in the range 20–25% of the GDP, were exceptionally high. In the first 5 years of transition, pensions of people outside agriculture, with the average pension at a level of 60–75% of the average wage, were also exceptionally high. These facts are at variance with the often strong criticism of the economic social policy in early period of transformation.
6. The reduction of inflation from near-hyperinflation levels in the first few months of transition to the world standard level was systematic, but also gradual, spread over some 12 years. The surprise was how long it took.
7. The privatization of state-owned enterprises was, in comparison with other European and USSR countries in transition, exceptionally gradual, but nevertheless the size of the private sector in terms of output and employment soon became high.[4] This development took place for three reasons: rapid reduction of outputs and employments in many state enterprises, exceptionally rapid expansion of the new private sector, and a fairly large private sector at the start of transition, much larger than elsewhere.
8. Domestic savings have been persistently exceptionally low, due to very low savings by households and always negative savings by the general government. Consequently, domestic private investment, usually around 12–15 % of the GDP, has also been exceptionally low. Here we have a sharp difference between Poland and China.
9. Employment in the low productivity agricultural sector was initially exceptionally high, and while declining, continues to be high. Employment of people age 50+ has been and remains low by Scandinavian and western European standards.
10. There were three cases of significant growth slowdowns over the last 25 years (2001–2002, 2009, 2012), with significant recessions in industry and construction, but there has been no case of economy-wide recession. The absence of such economy-wide recession in 2009, the worst year of world financial crisis, was in the European Union an exceptional development, often considered a big positive surprise.
11. The consistency of Polish economic policy making has been high despite many changes of government. This may be attributed to the unusual consensus of the economic elite on what needed to be done and what was and wasn't good economic policy.

Some of these facts have been noted and discussed in the Polish and international literature of comparative studies. In my own recent studies I discuss at some length facts 1, 4 and 10, largely from the perspective of long term and global developments (Gomulka 2016, 2017 and 2018). Let me note and discuss two misunderstandings which I often find in this literature.

One concerns the sources of economic growth: what are the key differences between the TFA countries and the catching up countries ?. Economists recognize that in the long run the per capita GDP is determined fully, or nearly fully, by qualitative changes, in particular by technological innovations and improvements in the human capital embodied in workers. In the TFA countries new technological changes are produced by the global R&D sector The growth of that sector has been exceptionally fast and stable over the last two centuries, Consequently the trend innovation rate has been fairly stable over time during those two centuries, similar across countries and

3 Gomulka, S., 1995, "The IMF-Supported Programmes of Poland and Russia, 1990–1994: Principles, Errors and Results", Journal of Comparative Economics. Vol. 20, July, 316–346.

4 Gomulka, S. and P. Jasinski, 1994, "Privatization in Poland 1989–1993: Policies, Methods and Results", in S. Estrin (Ed.) London, Longman.

almost independent of national economic policies, in particular nearly independent of the rate of investment.

However, in the catching up countries the mechanism generating qualitative changes is quite different. For, most technological changes that are taking place there at the enterprise level come about as a result of transfers from the TFA, where they were invented some time earlier. The rate of absorption of such innovations depends strongly on the national absorption ability, in particular on the rate of investment. This rate varies strongly among countries, as does the rate of qualitative changes and the rate of economic growth (Gomulka,2017). That rate can easily be, and often is, much higher than that prevailing in the TFA. This was also the case in Poland since 1990.

This difference in the mechanism of economic growth is often disregarded, with excessive weight being placed on the low number of newly patented domestic innovations as a key obstacle to technological and productivity changes, and on the low wages as a key advantage.

4 The green island phenomenon

The second misunderstanding concerns the original Polish official interpretation of the so-called "green island" phenomenon, which refers to the absence of an economy-wide recession in Poland during the recent world- wide financial crisis. In the year 2009 the GDP of the EU declined by 4.4% from the level in 2008, and by about 6% from the trend. Poland's GDP in 2009 increased by 1.7%, declining from the trend by only 2%. This official interpretation claimed government credit for that much better performance.

In my interpretation this much better performance of the Polish economy in 2009 was caused mainly by the following three factors:

1. Excessively expansionary monetary policy in the USA, where the crisis originated, and in most member countries of the EU, including transition countries except Poland and Slovakia, in the period 2002–2008. According to the IMF data, bank credits to the private sector as proportion of GDP increased in that period as follows: in Bulgaria from 26.0% to 66.7%, in Romania from 7.1% to 37.0%, in Estonia from 36.1% to 90.2%, in Latvia from19.0% to 85.8%,in Lithuania from13.1% to 61.9%. Baltic countries and Bulgaria operated at that time a fixed exchage rate regime with no own central bankig, with the domestic money supply decided by the size of the foreign exchange reserves. Just before the summer of 2008 these reserves were increasing fast, so was the money supply, forcing market interest rates strongly down.
2. According to the World Bank data, monetary policy in Poland was tight in the years 1999–2000, causing deep contraction of the construction sector and a recession in industry, but it was moderately expansionary in the years 2001–2007. In relation to GDP, domestic credit to the private sector fell sharply in the years 1999–2000 - stood at 26.5 % in 2000 and only 37.1% in 2007.[5] Note 5 Moreover, domestic credit fell in countries around Poland in the years 2009–2010, but in Poland it stood at 47.0% in 2009 and 48.8% in 20010, so it was expanding.
3. A highly expansionary fiscal policy was adopted in Poland not in response to, but just one year before the start of the crisis, when the financial crisis was not even anticipated. That policy, of the size of about 3% of GDP, was implemented in the years 2008 and 2009, increasing the fiscal deficit in the years 2009 and 2010 to nearly 8% of the GDP, the highest level during the entire transformation.

Given these large differences in the conduct of monetary and fiscal policies between Poland and other EU countries in period I (2001–2008) just before the financial crisis in 2008 and in the subsequent period II (2009–2015) just after the crisis, it is more accurate to compare the economic performance of Poland with that of these other countries in the period I + II. This I do in Table 1. Moreover, since the monetary policy of Poland was much different within period I, that comparison is made in Table I also for subperiods IA (2001–2004) and IB (2005–2008).

It turns out that in period IA the GDP increase in Poland was lowest among the eight transition countries of Central and Northern Europe. It is interesting that in the period 2001–2015, the leaders in economic growth in that part of Europe were Slovakia and Lithuania. Bulgaria, Latvia and Romania also achieved better results than did Poland. A clear outsider was Hungary. With respect to period II, what differentiated Poland most was the absence of a banking crisis.

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5 I provide a detailed discussin of the monetary policy in Poland in the years 1999–2000, conducted by the newly established Monetary Policy Council, in the paper "The Polish Conflict", published in (Quarterly Journal) Central Banking, vol XIII, No 1, August 2002.

Tab. 1. GDP increases in the periods indicated as percentages of initial levels

Country	IA	IB	I	II	I + II
	2001–2004	2005–2008	2001–2008	2009–2015	2001–2015
Lituania	34,0	31,9	76,7	4,1	83,9
Slovakia	19,8	35,6	62,4	12,3	82,4
Latvia	33,9	32,2	77,0	-1,9	73,6
Romania	27,0	30,6	65,9	3,9	72,4
Bulgaria	23,7	30,2	61,1	5,4	69,8
Poland	12,4	22,2	37,4	22,7	67.9
Estonia	28,8	23,4	58,9	5,2	67,2
Hungary	18,1	10,0	29,8	3,0	33,7
EU	8,2	9,2	18,2	-1,2	16,7

Source: Calculated by the author on the basis of latest IMF data.

The key reason of that was low level of underperforming bank loans to households and enterprises.

But a large increase of public debt in the years 2009–2011 forced the government to adopt a contractionary fiscal policy in the years 2012–2014. Moreover, the government was forced to take over half of the resources, about 8% of GDP, accumulated since the year 2000 in the second pillar of the pension system, consisting of privately managed open retirement funds. That transfer was officially misinterpreted as a 'needed correction of an error' in the original legislation concerning these funds, introduced by the Buzek government in 1998. That error was said to be in allowing pension funds to invest in Polish government securities (!).

5 Global long- term trends

The long-term risks which Poland is likely to face in the years ahead are more clear when discussed in the context of likely developments in the world economy. Historically the most striking development of this kind was noted and documented by Angus Maddison (2007), namely that the world per capita GDP rose on average by only 0.5% per decade during the Middle Ages 1000–1500, by 0,7% per decade, so only marginally faster, in the protocapitalistic epoch 1500–1820, but 17 times faster, 1.2% per year, in the period 1820–2000.

In a recently published paper (Gomulka, 2017) I review and discuss several lists of 'stylized facts' and 'stylized trends' of the world economy in the 20th century, and attempt to answer the question, whether and which of these facts and trends are likely to continue in the 21st century. Fundamental among them is the emergence,in the course of the 19th and most of the 20th centuries, of a very large gap in per capita GDP between the TFA countries and all the other countries.

However, during the last 40 years this particular feature of the world economy is undergoing a dramatic change, from a strong divergence to a strong convergence. Moreover, that convergence is expected to continue for some time at a fairly rapid rate. As a result, the world per capita GDP growth rate is likely to be significantly higher.in the years to come, especially during the first half of this century, than the 1.2% trend rate of the 19th and 20th centuries

In a discussion about the place of the Polish economy in the years ahead, it is important to note and accept that this world per capita GDP growth rate, recently at a historically exceptionally high level of about 3%, is likely to remain at that level for some time, at least during the next 30–40 years.

Growth convergence is in part a product of technological integration of national economies into a single world economy. That process of integration has progressed particularly forcefully in Europe during the last 50- years. There have been institutional implications of that forceful technological integration. One of them is the creation of the European Union, European Central Bank and euro as the common currency for almost all EU countries. Before the euro was adopted the countries of southern Europe didn't care as much about inflation as postwar Germany did. Consequently the govern-

ments in those countries had the option of adopting expansionary fiscal policy to win popular support and choosing devaluation later on to restore competitiveness. Germany suffered hyperinflation in the early 1920s, and the social cost of that experience was apparently so powerful that it changed political culture in Germany and the neighboring countries. As a result, these northern European countries have become more responsible in their fiscal policies, so much so that exchange rates of their currencies tended to appreciate.

Technological integration of countries within the EU has meant that exporting firms as a group are now also big importers, and exports and imports are large proportions of GDP. Moreover, financial integration meant that much private and public debt became denominated in foreign currencies.

In such circumstances the potential benefit of having national currency for the purpose of keeping available the option of devaluation, has declined for all EU member countries. This created the economic conditions in the entire EU far more conducive than before to introduce and keep a common currency. In 2008, but just before the eruption of world financial crisis, the polish zloty was strong against foreign currencies, much stronger than it is now. Yet most Polish exporting firms were comfortably profitable then, almost as much as they are now. But the key condition to meet before adopting the euro is to have low public debt, therefore the average budget deficit to be close to zero. That condition was not met by several member countries of the EU, in particular by Greece, and is not yet met by Poland.

Much research in comparative economics has been so far about the role of institutions in economic development. Given the central role of the rate of technological innovation in determining the rate of development, in the focus of this research was essentially the causal relationship between institutions and the rate of innovations. Less attention has been given to the reverse relationship, one between cumulative technological changes and institutional changes. The volume of technological changes increases exponentially, and over the last two centuries it has been increasing at a high rate. Consequently, increases in that volume per unit of time are now much bigger than they were a century ago, or even a few decades ago. Their potential to cause institutional changes is proportionately also much higher than it was in the distant past.

6 Long-term trends in Poland which cause concern

With respect to risks for Poland's development in the years ahead, the facts which cause particular concern are the following:

1. A large gross emigration of workers of about 2.5 million, and still significant net emigration, of about 1,5 million, representing about 10% of the working population;
2. A new demographic trend that just started and is expected to continue, which implies that the population of Poland will fall until the year 2050 by about 5 million, or about 13%;
3. The effective retirement age is low and, in response to recent lowering of official retirement ages, will probably decline further. Consequently the number of pensioners, already large, will be increasing;
4. The domestic savings rate is exceptionally low and this is likely to continue. Consequently the domestic investment rate is also likely to be low, and, as a further consequence, the innovation rate and growth rate of GDP per worker will be lower;
5. The net inflow of foreign savings is likely to decline, certainly from the UE budget and probably also from private investors.

The combined effect of these developments will be a declining population and, probably, a strongly declining trend rate of growth of the per capita GDP, from about 3.5% per year during the transition so far to about 2% in the next 10–20 years, and lower still later on. In the absence of defensive policy measures, a significant catching up of Poland's per capita income and wealth with those of the TFA countries may well continue only for the next -10 years or so. Under this scenario, my own tentative forecast is that the catching up would (nearly) stop when the per capita GDP(PPP) in Poland will reach about 70% of the corresponding level in Germany and about 60% of that in the USA. That would be about twice the relative level prevailing during the last two centuries, but probably below the aspirations of the people living in Poland.

What is important for the quality of life is not only the average level and distribution of income per person, but also the average level and distribution of wealth per person, the quality of public sector (non-market) services and the quality of the environment. In these three aspects the distance between most developed countries

of the EU and Poland may well yet be much higher than that in terms of the per capita GDP.

7 Poland's controversial and risky policy responses

During the last three years an unusual confrontation of economic and institutional ideas and policies has been taking place in Poland. Several competing strategies have been proposed: a single Strategy A of the government and several non-government strategies. It is interesting that the central long-term aim is the same in all strategies: to avoid the middle-income trap. Also the same are the proposed two key economic policy instruments: substantial increases in the rate of domestic saving and in the rate of total investment in fixed assets. But. the government, as part of Strategy A, has also proposed to increase substantially social transfers, reduce significantly retirement ages, reduce foreign direct investments, increase the size of the state sector, and increase the role of state preferences in important investment decisions.

Implementation of some initially proposed components of Strategy A has been abandoned. This reduced the risk of a crisis in public finances. Still, the rate of investment remains low, one of the lowest in the EU, and is likely to remain low. A tight labor market started to produce a wage pressure that should in due course increase inflation. Despite an exceptionally high rate of growth of tax revenues and the presence of fairly large one-off revenues, the budget deficit of the general government has continued to be close to the upper limit of 3 % of the GDP.,This produces the risk that the expansion of public debt will accelerate in the years of slower growth, and as a consequence of promised much higher public expenditures on health, pensions and defense. If this risk comes about, the cost of servicing public debt would also increase.

But the most controversial, even revolutionary, are the institutional changes introduced already during the last three years. 2016–2018. They include the imposition of a strict political control over the public radio and television, civil service and, most importantly, an attempt to impose such a control over the whole judiciary system, including the Constitutional Tribunal, the National Judiciary Council and the Supreme Court. The original program of the governing Law and Justice party accepts with only considerable difficulties the ideas of competitive market capitalism and the values underlying the common principles of the European Union. It is also strongly, even emotionally, critical of the economic, institutional and political transformation since 1989 until 2015. Consequently, the prospect of a system has suddenly emerged in which one and the same political party will be in power for long. In the meantime, an unusually rapid remodeling of the rules-based liberal order is under way.

But some important differences compared with the pre-1989 system are yet present. They include acceptance by the present government of a large private sector, (formal) acceptance of the membership of the European Union, active presence of the political opposition and an important role for the private mass media. These differences are probably still sufficiently large to keep the prospect alive of Poland remaining a fully democratic country and an influential member of the European Union. However it is rather certain that membership of the eurozone remains now a distant possibility.

Refereneces

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