

# Modern Growth Theories

## Lecture 10

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# Growth Strategies

# 1989 - fall of communism in Poland

- In the winter of 1988 Poland experienced massive strikes.
- The government initiated the discussion with the banned trade union Solidarity and other opposition groups in an attempt to defuse growing social unrest.
- **Round Table Talks** (February 6 - April 5 of 1989) - beginning of Polish political and economic transformation.
- Polish officials agreed to have free, democratic elections to the lower house of Polish parliament and senate.

## **The main problems of the Polish economy before 1990**

- Foreign debt (the Paris Club - group of financial officials from the world's biggest economies, the London Club - group of private creditors).
- In the second half of 1989 the level of foreign currency reserves was close to zero resulting in inability to purchase even the most crucial products from abroad.
- Chronic shortages, queues and inability to satisfy basic consumer needs.
- Hyper-inflation.
- Budget deficit.

## Foreign debt, 1971-1989 (USD, billion)

Source: G.W. Kołodko, *Od szoku do terapii. Ekonomia i polityka transformacji*. Poltext. Warszawa 1999, p. 34.

Year	Debt	Year	Debt
1971	<b>1.3</b>	1981	25.5
1972	1.7	1982	25.2
1973	3.1	1983	26.4
1974	5.3	1984	26.8
1975	8.4	1985	29.3
1976	12.1	1986	33.5
1977	15.4	1987	39.2
1978	18.5	1988	39.2
1979	21.9	1989	<b>40.8</b>
1980	25.0		

# Rationing and queuing – a way of life

## Ration coupons:

- Sugar (13-08-1976 – 01-11-1985),
- Meat (28-02-1981 – 31-07-1989)
- Butter, flour, rice, cereal products (30-04-1981),
- Chocolate, sweets, alcohol, oil, washing powder.

Mąka 1000 g XI 82	Cukierki 250 g XI 82	Cukier 500 g XI 82	Cukier 1500 g XI 82	Papierosy 6 pacz. XI 82
P. zbożowe 1000 g XI 82	<b>W. Z. Nr</b> <b>P-3</b> nazwisko i imię adres: gmina-miasto-dzielnica			Papierosy 6 pacz. XI 82
Proszek 200 g XI 82				Alkohol 1 but. XI 82
Proszek 100 g XI 82	R-Pili 10 XI 82	Tłuszcze 375 g XI 82	Czekolada 100 g XI 82	R-Pili 20 XI 82

Rezerwa M-II	Mięso 600 g 1989-8	Mięso 500 g 1989-8	Mięso 500 g 1989-8	Mięso 300 g 1989-8
Wol., Ciel. z kością 700 g 1989-8	<b>B 0739484</b> nazwisko i imię adres: -			Mięso 300 g 1989-8
Wol., Ciel. z kością 300 g 1989-8				Mięso 300 g 1989-8
Rezerwa 5 1989-8	Rezerwa 6 1989-8	Mięso 100 g 1989-8	Mięso 100 g 1989-8	Mięso 300 g 1989-8

# Inflation

Source: [www.stat.gov.pl](http://www.stat.gov.pl)

Year	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
<b>1989</b>	11.0	7.9	8.1	9.8	7.2	6.1	9.5	39.5	34.4	54.8	22.4	17.7
<b>1990</b>	79.6	23.8	4.3	7.5	4.6	3.4	3.6	1.8	4.6	5.7	4.9	5.9

- Poland mainly relied on heavy industry which was characterized by the lack of any motivational or competitive mechanisms, monopolization, inefficiency and outdated technology. Industry relied on massive subsidies.
- The agriculture was mainly based on small farms which could only survive if subsidized. Farmers did not know how to function in a free market economy.
- Service sector was minimal, light industry and distribution underdeveloped.



- **Macroeconomic stabilization** – limiting budget deficits, reducing inflation and establishing fully convertible currency with real exchange rate.
- **Economic liberalization** – market competition and the institutions of private property.

## Poland 1990 – The Balcerowicz Plan

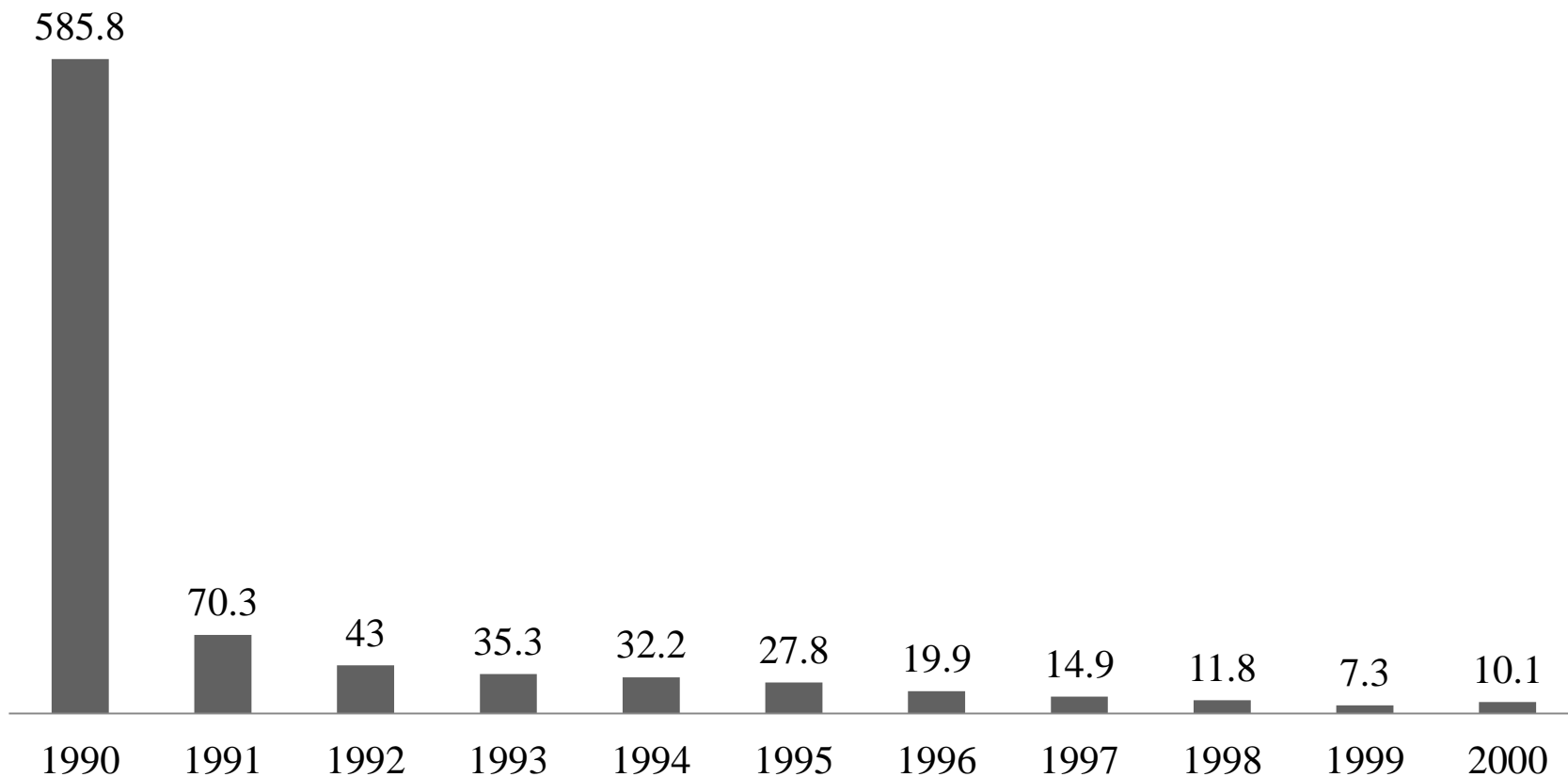
<b>Act on Financial Economy Within State-owned Companies</b>	The Act abolished the principle under which, unprofitable state-owned companies were financed from budget and allowed state-owned companies to declare bankruptcy.
<b>Act on Banking Law</b>	The Act prohibited the central bank to finance the budget deficit and issue unlimited amount of money.
<b>Act on Credits</b>	The Act abolished preferential loans for state-owned companies and tied interest rates to inflation rates.
<b>Act on Taxation of Excessive Wage Rise</b>	The Act introduced tax on extensive wage growth (so called popiwek).
<b>Act on New Rules of Taxation</b>	The Act uniformed tax rule for all sectors of the economy

## Poland 1990 – The Balcerowicz Plan

<b>Act on Economic Activity of Foreign Investors</b>	The Act allowed companies with foreign capital to repatriate their profits and exempted them from paying the tax levied on extensive wage growth. The Act obligated those enterprises to sell foreign currencies to the state. The exchange rate was set by the central bank.
<b>Act on Foreign Currencies</b>	The Act introduced internal convertibility of the Złoty, abolished the state monopoly in international trade and obligated companies to sell foreign currencies to the state.
<b>Act on Customs Law</b>	The Act introduced the same customs law for every business entity.
<b>Act on Employment</b>	The Act regulated the responsibilities of unemployment agencies.
<b>Act on Special Circumstances Under Which a Worker Could be Laid Off</b>	Act guaranteed severance pay and temporary unemployment benefits for those who lost their jobs.

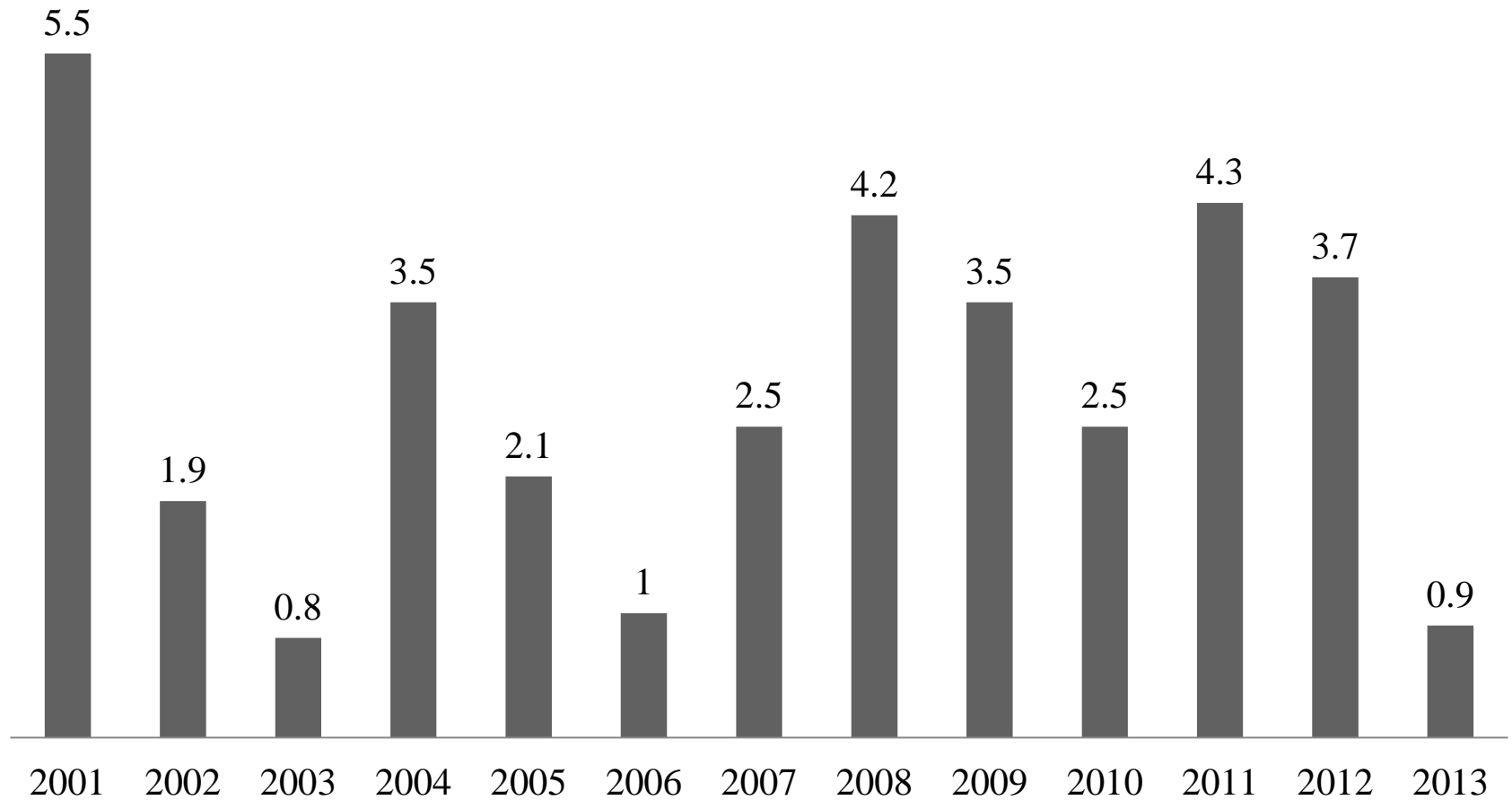
# The effects of the Balcerowicz Plan - inflation, Poland, 1990-2000

Source: [www.stat.gov.pl](http://www.stat.gov.pl)



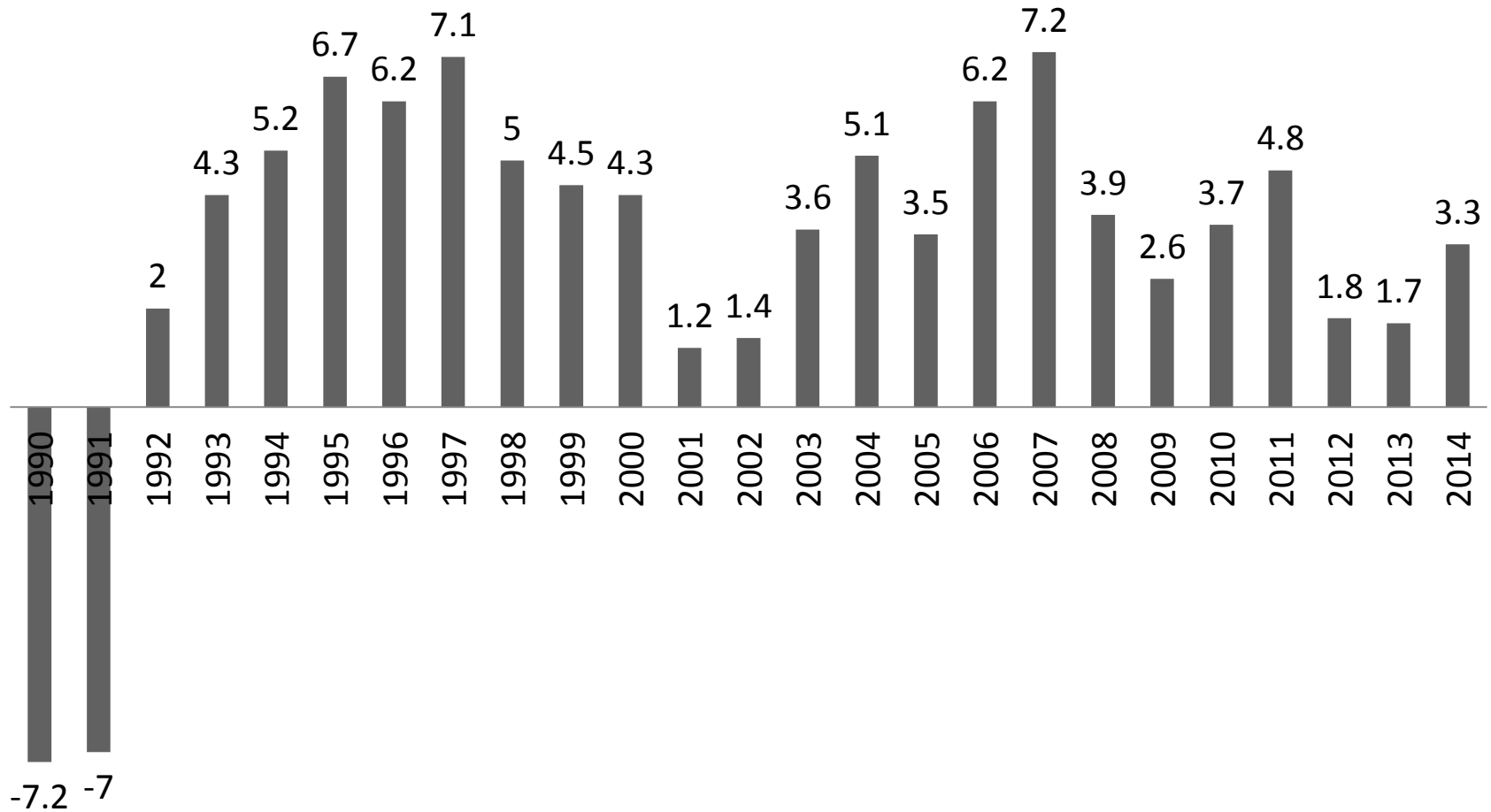
# Inflation, Poland, 2001-2013

Source: [www.stat.gov.pl](http://www.stat.gov.pl)



# Real GDP growth (Annual percent change), Poland, 1990-2014

Source: [www.imf.org](http://www.imf.org)



## By the year 2004 in Poland

- economic policy was relatively predictable, stable and prudent,
- basic institutions of the capital market were created,
- the banking sector was developed,
- labour efficiency and international competitiveness increased,
- exports and investments increased.

# The main engines of growth 2004-2007

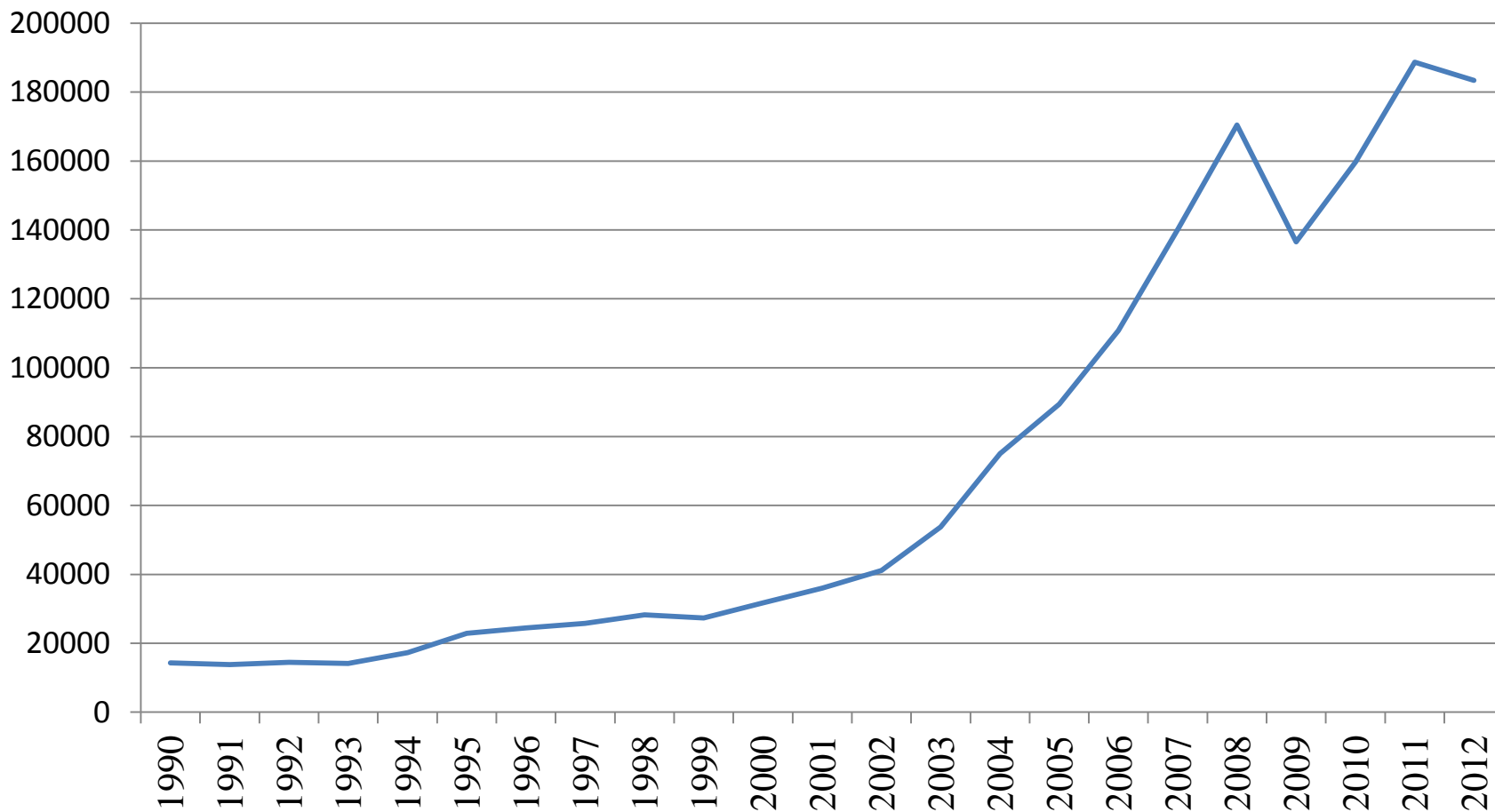
The accession led to

- trade creation,
- decrease in investment risk,
- visible effects of the production shift from Western Europe,
- access to the EU development funds.



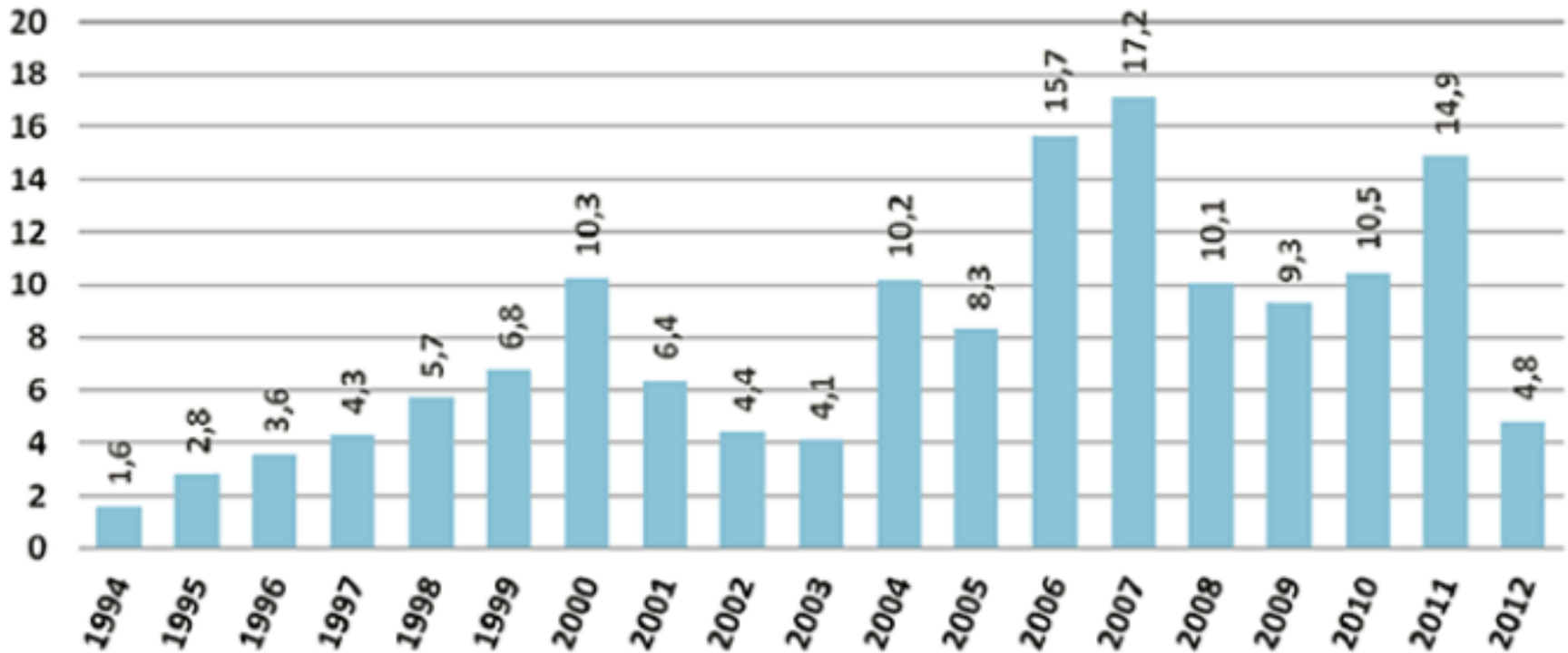
# World merchandise exports of Poland, 1990-2012 (USD million)

Source: World Trade Organisation, International Statistics 2013



## FDI Inflow to Poland, 1994-2012, EUR billion

Source: [www.paiz.gov.pl](http://www.paiz.gov.pl) (Polish Information and Foreign Investment Agency)



## **The main engines of growth 2004-2007**

- The effects of the accession (trade and investment creation) + the internal effects of the stronger domestic demand and production.

# Impact of global financial crisis on Polish economy

Source: W. Orłowski, 2011, p. 15.

The main channels of the impact of the global financial crisis on Poland were:

- the fall of exports, caused by the deep recession in Western Europe,
- the fall of FDI due to the increased risk aversion vis-à-vis emerging markets,
- the fall in the consumer confidence due to the risk of growing unemployment,
- the problems on the credit markets, due to the effects of the global credit crunch,
- the worries about the possible reduction of access to international capital markets,
- 2008-2009 - the Złoty depreciated by 40%.

## **The main reasons that can explain a good performance of Poland during the global financial crisis are:**

- a relatively big domestic market and limited dependence on exports,
- the cautious conduct of the economic policy and of banking supervision in the past years, that did not allow an excessive dependence on foreign financing,
- the stabilizing role of the inflows of the EU development funds,

- the weakening of the Złoty that helped Polish exporters to deal with the fall of the demand and reduced the growth of unemployment,
- the relatively low level of indebtedness of Polish households and companies, and a reduced share of the loans denominated in foreign currency.
- high profitability and a strong portfolio of assets in the banking sector.

## The main engines of growth 2008-2012

- The main engines of growth were:
  - the domestic consumption
  - the public investment (increase of the EU co-financed public investment projects – the use of funds contributed to the upgrade of the infrastructure, enhancing the supply side capacities of the economy).

- **Poland's main economic strength** lies in the investment attractiveness caused by the success of the economic transformation combined with the favourable geopolitical localization.
- Reasonably high productivity, moderate labour costs, political, social and economic safety.
- The competitive cost of skilled labour, 4-5 times cheaper than in Western Europe.



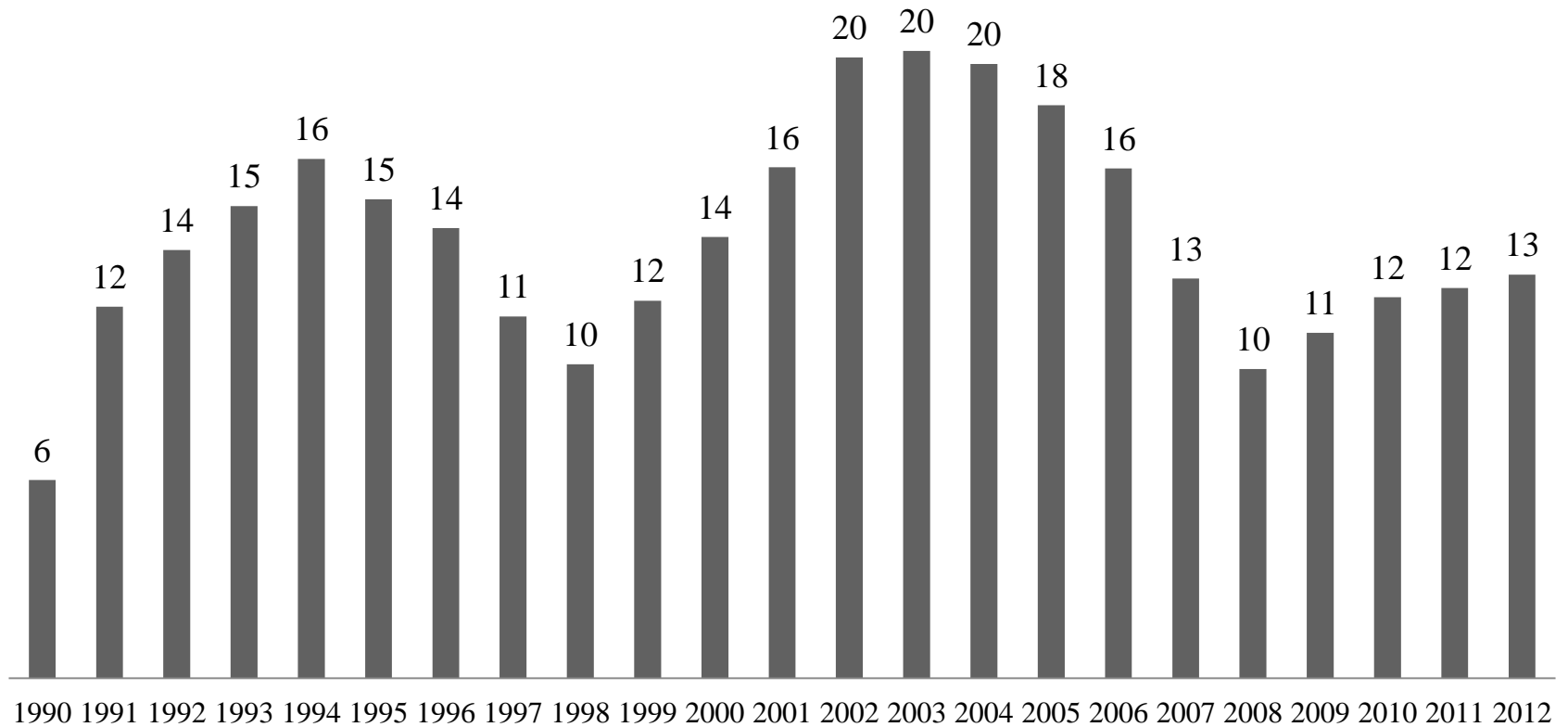
- **The main weakness of Poland** is the poorly performing public sector. As a result, the business environment in Poland is marked by the overwhelming bureaucracy, poor quality of public services, extremely inefficient judicial/legal system and lack of business-friendly legal framework.

- Polish work force had strong political power.
- The Solidarity movement offered many privileges to miners, rail workers and other large groups of employees.

# The effects of the Balcerowicz Plan

- Despite these successes, the Balcerowicz Plan was heavily criticized for causing a radical decline in living standards for large groups of people, mainly workers of unprofitable state-owned enterprises and state-run farms (PGRs) which were dissolved after 1989.
- The result were many poverty-stricken regions and structural unemployment that persists in some areas to this day.

# Unemployment rate (annual, percent), Poland, 1990-2012

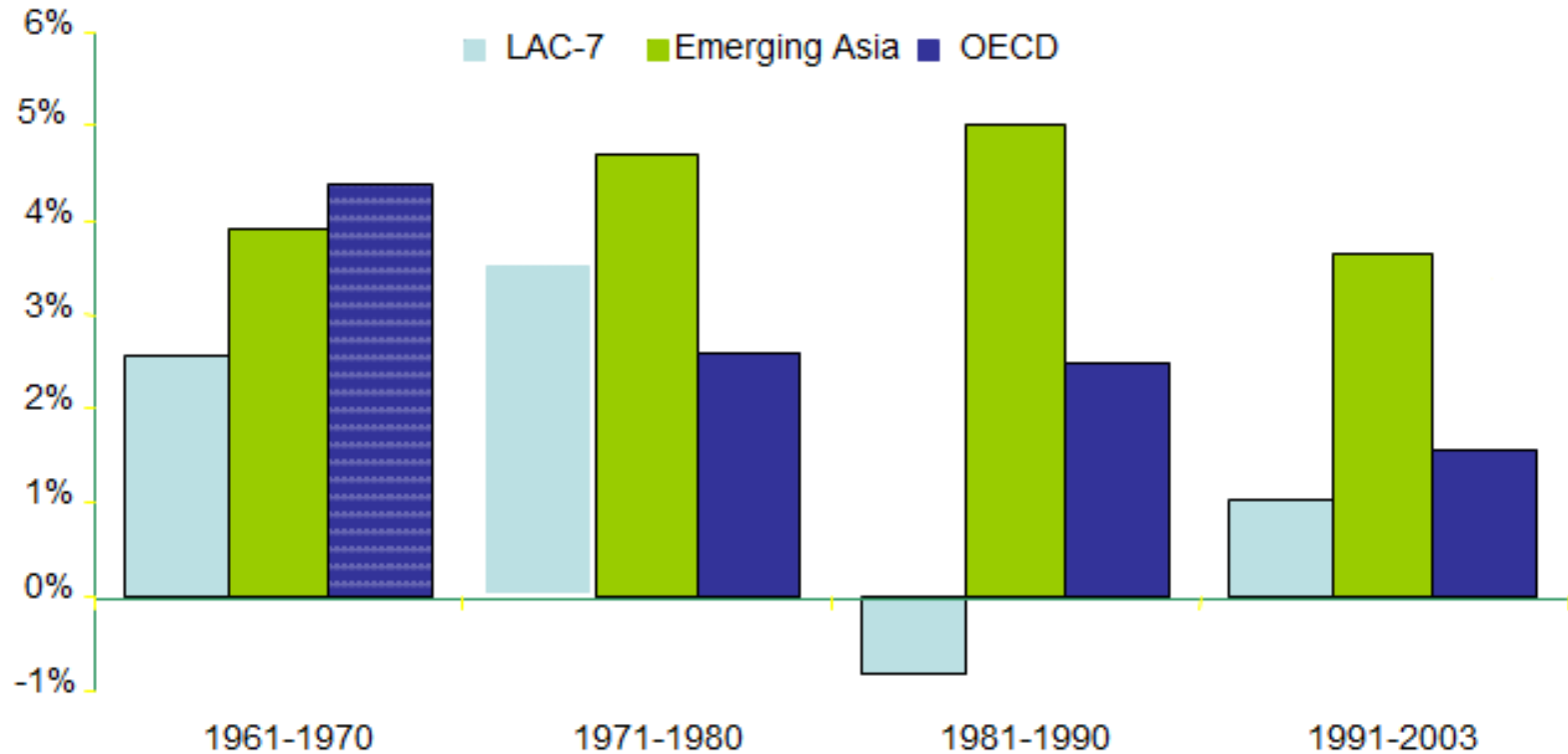


# Growth Strategies – Washington Consensus

Source: Rodrik D., Rethinking Growth Strategies, WIDER Annual Lecture 8, 2005, p. 12.

<b>Original Washington Consensus</b>	<b>Augmented Washington Consensus the previous 10 items, plus:</b>
<ol style="list-style-type: none"><li>1. Fiscal discipline</li><li>2. Reorientation of public expenditures</li><li>3. Tax reform</li><li>4. Financial liberalization</li><li>5. Unified and competitive exchange rate</li><li>6. Trade liberalization</li><li>7. Openness to FDI</li><li>8. Privatization</li><li>9. Deregulation</li><li>10. Secure Property Rights</li></ol>	<ol style="list-style-type: none"><li>11. Corporate governance</li><li>12. Anti-corruption</li><li>13. Flexible labour markets</li><li>14. Adherence to WTO disciplines</li><li>15. Adherence to international financial codes and standards</li><li>16. “Prudent” capital-account opening</li><li>17. Non-intermediate exchange rate regimes</li><li>18. Independent central banks/inflation targeting</li><li>19. Social safety nets</li><li>20. Targeted poverty reduction</li></ol>

Source: Rodik D., Rethinking Growth Strategies, WIDER Annual Lecture 8, 2005, p.3



Emerging Asia includes Indonesia, Korea, Malaysia, Philippines and Thailand  
LAC – Latin American Countries

Source: Rodik D., Rethinking Growth Strategies, WIDER Annual Lecture 8, 2005, p. 5

Country	Growth rate in the 1990s	Trade policies in the 1990s
China	7.1	Average tariff rate 31.2%, NTBs, not a WTO member (11 December 2001)
Vietnam	5.6	Tariffs range between 30-50%, NTBs and state trading, not a WTO member (11 January 2007)
India	3.3	Tariffs average 50.5%

# East Asian Anomalies

Source: Rodrik D., Rethinking Growth Strategies, WIDER Annual Lecture 8, 2005, p. 6

<b>Institutional domain</b>	<b>Standard ideal</b>	<b>„East Asian” pattern</b>
Property rights	Private, enforced by the rule of law	Private, but government authority occasionally overrides the law (esp. in Korea)
Corporate governance	Shareholder (“outsider”) control, protection of shareholder rights	Insider control
Business-government relations	Arms’ length, rule based	Close interactions
Industrial organization	Decentralized, competitive markets, with anti-trust enforcement	Horizontal and vertical integration in production (chaebol); government-mandated “cartels”



# East Asian Anomalies

Source: Rodrik D., Rethinking Growth Strategies, WIDER Annual Lecture 8, 2005, p.6

<b>Institutional domain</b>	<b>Standard ideal</b>	<b>East Asian” pattern</b>
Financial system	Deregulated, securities based, with free entry. Prudential supervision through regulatory oversight	Bank based, restricted entry, heavily controlled by government, directed lending, weak formal regulation
Labor markets	Decentralized, deinstitutionalized, “flexible” labor markets	Lifetime employment in core enterprises (Japan)
International capital flows	“Prudently” free	Restricted (until the 1990s)
Public ownership	None in productive sectors	Plenty in upstream industries