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While sanguine on Poland’s general economic progress, he’s been unimpressed by the fiscal performance of Prime Minister Donald Tusk’s government, and says the country urgently needs better universities and research centers and an aggressive push to attract more foreign direct investment.

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In the meantime, he’s built a vast archive from his time as adviser to the government in 1989-2002 – a 3,500-page treasure trove he recently handed over to the University of Warsaw library. A former deputy minister of finance, Gomułka has also served as a consultant to the IMF, the OECD and the European Commission, and worked as an adviser to the Russian government in the 1990s. He spends his spare time gardening at his residence near Warsaw, and visiting his grandsons in London.

WRJ Observer: You were part of the team that prepared the economic transformation plan for Poland after the collapse of communism. What made you believe then that the plan would work?

Stanisław Gomułka: Somehow I didn’t have any doubt that it would work. The most important thing was total agreement among the people regarding the collapse of the old economic and political order. The former communist elite also agreed the system had failed and so they collaborated with us in the transformation to a new one.

This widespread agreement led to the general opinion that in Poland we had to have the economic system which had won the competition, namely a market-based system. I expected the human cost to be quite significant. In this I differed from most of our foreign advisers and institutions.

Schumpeterian creative destruction was unavoidable under the large impact of two inevitable developments: a massive change in relative prices and a destruction of the close trade links with the former Soviet Union and its satellite countries.
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INTERVIEW BY REMI ADEKOYA

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It was clear that a substantial part of the old system of trade unionism still lived on, as the competition and be put out of use, many state firms would have to be initially down-sized or even closed down. It thought it would be a success if in the initial phase of transformation unemployment was limited to 20 percent. What was unclear to me was how fast the new private sector would emerge. The big- gest surprise was how quickly it appeared in Poland. In the years 1989-1992, some 2 million new companies were established. I was also an adviser to the Russian government at the time and there it took some 10-12 years for a private sector of that size to emerge. Reforms in Poland were also more acceptable thanks to the fact that state companies were not run by ministers but by supervisory boards which were largely appointed by the Solidarity trade union. In no other country in the CEE region did trade unions have such power.

So you were confident Poles would cope? Yes, but not entirely confident that the cost would be low enough for people to accept the results. However, we had no alternative. We knew that the cost of transformation would not be borne by foreigners. We asked the West to reduce our debt. I was part of the team that negoti- ated a 50 percent debt- relief from Western governments and banks. This was probably the most we could achieve them.

Looking back now, is there anything you would do differently? Yes, the government then was too generous toward pensioners. After communism collapsed, pensions increased to more than 70 percent of the average wage, up from about 50 percent in the old system. The government’s inability to keep that part of the reform under control had a devastating impact on public finances, the repercussions of which are still being felt today.

One of the first confrontations we had was when the boss of FSO, an automotive company in Warsaw, wrote in the early 1990s to the finance minister saying that if they did not receive immediate help, the com- pany would go bankrupt and half a million people would lose their livelihoods. We knew if we entered into such negotiations with one factory, there would immediately be others asking for the same. So our an- swer had to be a strong no. And it was... How did the Polish economy do in 2013 and what do you expect for the year? There was a strong slowdown but no recession in 2013. The growth of net exports kept things going last year even though domestic demand was weak and even declined for several quarters. Poland’s economy grew at an annual rate of about 1.5 percent for the whole year. This is not very impressive, especially for an economy which is catching up to the more developed economies. Poland’s GDP growth rate is sometimes compared to those of Germany or France, but such comparisons are not appropriate. Poland should be compared to Turkey, Brazil, India or China, as their emerging economies are all at a similar level of de- velopment, trying to take advantage of the catch-up factor in their pursuit of the most developed countries. Such a comparison would show that Poland is not doing as well as those countries.

Still, in the last two decades, Poland has grown in terms of GDP per capita at 4 percent a year while the most developed European economies grew at about 1.5 percent. In those twenty years the speed at which we were catching up was quite rapid. In 1990 our GDP per capita was about 30 percent of West Germany’s level, while today that figure stands at about 50 percent. The question is whether that pace of catching up can be maintained over the next two decades.

Do you agree with those who expect faster GDP growth this year? Yes, data which we saw for Q3 and Q4 of 2013 indicate that a growth rate of 3 percent on a yearly basis. Investment also started to grow, though very modestly, at something like a tenth of the standard rate of growth. This indicates that the room for improved performance this year and next is substantial.

Economic conditions are improving in Germany and the UK, so this and low wage costs should help our exports. At this early stage of recovery, one should also expect a contribution to growth from investments in inventories. Wage pressure will be moder- est, hence inflation will remain low and so will interest rates. This should help to sustain the growth recovery process.

Talking about wages and consumption, even though the rate of productivity is rising in Poland by about 5 percent a year, according to Eurostat there has hardly been a hedge in real wage growth. So where are consumers to get the money to spend? Bank loans.

Isn’t it paradoxical that governments are being told to live within their means whereas households are encouraged to borrow money in order to keep con- sumption demand going? There is a big difference between Poland and Western Europe in this respect. In the years before the crisis in 2008, monetary policy in Poland was fairly restrictive. The ratio of total private credit to GDP was low. Mortgages represented only 10 percent of our GDP whereas in the US they were about 100 percent of GDP. As a result, in the period 2008-2010, which was a period of crisis in the financial sector in Poland. Today, the debt of our household sector in relation to GDP is still relatively modest.

At what level is it exactly? At roughly a third of our GDP. This is quite modest by western standards, espe- cially as low interest rates mean that the cost of servicing these loans is low.

So what is a safe debt threshold? In advanced countries households are much more indebted than in Poland. The total public and private debt in those coun- tries stands at some 200 to 400 percent of GDP, more than twice the level in Poland. The maximum level of our household debt should be, in my extimation, around 60 percent of GDP. It is now roughly 35 per- cent, so there is still room for an increase. Of course, if we were to have a sharp increase in interest rates, then the loans would be more costly to service and we would probably see an increase in non- performing loans. But we are expecting no such rate hike.

At the height of the last boom in Poland, 2007-08, the official unemployment rate was roughly 10 percent. Today it is over 13 percent. On what basis is the govern- ment assuming an improvement in the labor market when no one is expecting a boom this time around? The Eurostat figures, which show people actually out of work and not just those reg- istered as unemployed, have the unemploy- ment rate in Poland lower by about three percentage points than the official Polish figures.

Are you saying people who have jobs in Poland apply for unemployment benefits? Not for unemployment benefits. Only a few of those out of work get unemployment benefits. But many are registered as unemployed so they can have free public healthcare. That is the actual benefit they are after. Still, the 10 percent Eurostat unemployment rate in Poland is high in comparison to many European Union economies.

Even though most of them are currently in stagnation while Poland apparently isn’t? That’s right. Clearly, the so-called natural unemployment rate in Poland is too high. There are big cities, forming to the so-called Poland A [the west of Poland, which is significantly more developed economi- cally than Poland B due to political, and cultural distinctions linked to the country’s history], where the unemployment rate is low and comparable to those observed in developed Western countries. But we also have the so-called Poland B, where the unemployment rate may in some areas exceed 20 percent.

This despite the fact that over 2 million Poles emigrated after Poland joined the EU. If they had stayed, the unemploy- ment picture would look much worse. Yes, that’s true. Unemployment would be worse now if not for that factor. What is interesting is that young people from Poland B often find it easier to get jobs in London than in Warsaw. In Warsaw there are substantial barriers for them, such as high rent rates. Warsaw rent rates are hardly higher than those in London…

Yes, but in London you can rent a room and share it with several people. You don’t have that kind of feasibility in Poland. Also, London wages are definitely higher than Warsaw wages. However, in the future, the government should try to do something to bring back those Poles, especially as we are facing a serious decline in our working population.

There should be a better utilization of the workforce that exists, by reducing the barriers to employment between Poland A and...
It was clear that a substantial part of the old economy was not going to compete and be put out of use, many state firms would have to be initially downsized or completely closed down. I thought it would be a success if in the initial phase of transformation unemployment was limited to 20 percent. What was unclear to me was how fast the new private sector would emerge. The biggest surprise was how quickly it appeared in Poland. In the years 1989-1992, some 2 million new companies were established. I was also an adviser to the Russian government at the time and there it took some 10-12 years for a private sector of that size to emerge. Reforms in Poland were also more acceptable thanks to the fact that state companies were not run by ministers but by supervisory boards which were largely appointed by the Solidarity trade union. In no other country in the CEE region did trade unions have such power.

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Do you agree with those who expect faster GDP growth this year? Yes, data which we see for Q3 and Q4 of 2013 indicate that a growth rate of 3 percent is possible this year.

What will drive that growth? Domestic demand will play a much bigger part than in recent quarters. In Q3 2013, after 5 quarters of decline, domestic demand started to grow at a rate of about 1 percent on a yearly basis. Investment also started to grow, though very modestly, at something like a tenth of the standard rate of growth. This indicates that the room for improved performance this year and next is substantial.

Economic conditions are improving in Germany and the UK, so this and low wage costs should help our exports. At this early stage of recovery, one should also expect a contribution to growth from investments in inventories. Wage pressure will be modest, hence inflation will remain low and so will interest rates. This should help to sustain the growth recovery process. Talking about wages and consumption, even though the rate of productivity is rising in Poland by about 5 percent a year, according to Eurostat there has hardly been a hodge in real wage growth. So where are consumers to get the money to spend? Bank loans. Isn’t it paradoxical that governments are being told to live within their means whereas households are encouraged to borrow money in order to keep consumption demand going? There is a big difference between Poland and Western Europe in this respect. In the years before the crisis in 2008, monetary policy in Poland was fairly restrictive. The ratio of total private credit to GDP was low. Mortgages represented only 10 percent of our GDP whereas in the US they were about 100 percent of GDP. As a result, in the years 2005-2008 there was no crisis in the financial sector in Poland. Today, the debt of our household sector in relation to GDP is still relatively modest.

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Of course, if we were to have a sharp increase in interest rates, then the loans would be more costly to service and we would probably see an increase in non-performing loans. But we are expecting no such rate hike.

At the height of the last boom in Poland, 2007-08, the official unemployment rate was roughly 10 percent. Today it is over 13 percent. On what basis is the government assuming an improvement in the labor market when no one is expecting a boom this time around?

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Warsaw rent rates are hardly higher than those in London. Yes, but in London you can rent a room and share it with several people. You don’t have that kind of flexibility in Poland. Also, London wages are definitely higher than Warsaw wages. However, in the future, the government should try to do something to bring back those Poles, especially as we are facing a serious decline in our working population.

There should be a better utilization of the workforce that exists, by reducing the barriers to employment between Poland A and the rest of the world. We need better universities, more efficient research centers, increased FDI.

If you are thinking about startup and looking for financing, create your pitching under expert’s wing, take part in dinner with investors and learn, what are they thinking about your project. Join unique seminar and meet our guest Tomasz Grzybowski, experienced mentor in startup companies. 21th 23th March 2014, Hotel Starzyński Tumskie Hill, Płock www.startuptuning.pl
and Poland B. The supply of workers may also be increased by the injection of some immigrants from Slavic countries. Immigrants tend to be more skilled than average, more mobile and some of them are quite entrepreneurial.

Every year 500,000 people graduate from Polish universities. But in 2012, fewer than 70,000 net jobs were created by the Polish economy as a whole. What has to happen for more workplaces to be created, especially for graduates? The creation of new jobs is related to investment and investment has been really modest in Poland in recent years. Investment as a percentage of Polish GDP has been in the range of 15-25 percent in the last two decades. In China, it’s been about 40 percent. In Japan, South Korea and Singapore, it’s also been much higher than in Poland, as national savings and investments in those countries make up 30-50 percent of their GDP.

In Poland, national savings are low, one reason is the government deficit. Poland needs the fiscal deficit of the general government to be close to zero. If this were to happen, private investment should increase.

What is the correlation between government spending and private savings or investments?

If the government deficit is reduced, then that of itself will have little impact on private savings. But public dissaving will be reduced, so total national savings will go up. This should also permit higher investment. If, in addition, reforms made in the public sector result in reduced tax burdens, then this could encourage some people to save more.

To reduce the so-called natural rate of unemployment, we need more and better vocational schools in Poland. I am advising authorities to adopt the German system of that type of education, widely considered as the best in Europe. If these structural changes take place, there could be a better match of supply and demand on the labor market.

Polish government figures put the public debt-to-GDP ratio at 53 percent. However, Leszek Balcerowicz has said with the hidden debt it holds, Poland’s public debt burden is closer to 250 percent of GDP. Where do you stand on this issue?

It is unfortunate that in the public domain there are a number of competing definitions of the official public debt. The difference between Eurostat and Polish estimates was insignificant six years ago. But the then Finance Minister, Jacek Rostowski, started to innovate, basically manipulating figures, and now the difference is more than three percentage points in relation to GDP.

The issue of so-called hidden debt is another potential source of confusion. Poland’s hidden debt is similar to that of Italy, France or Germany, where it is estimated to be between 100 and 300 percent of GDP. In Poland, it is according to some unofficial estimates about 200 percent of GDP.

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What could be the consequences of this hidden debt? How long is everybody just going to pretend it doesn’t exist?

There is a big difference between official and unofficial (hidden) debt. Official debt is internationally traded on financial markets, whereas unofficial debt is not traded. Unofficial debt is the duty of the state to meet its obligations, such as pensions, towards citizens, at some later stage.

Financial markets and ratings agencies are not concerned by this type of debt. If, at some point in the future, the government has difficulty meeting its obligations, there will be no crisis involving international investors but rather a domestic crisis involving just households. One possible resolution of the crisis is to tell households that past governments were foolish, the current government cannot meet the obligations they were dumped with, and has to reduce them by appropriate legislation.

Has the government of Prime Minister Donald Tusk done enough to improve Poland’s fiscal situation?

During the last six years, Mr Tusk’s government has done very little to improve things on this front. The budget deficit increased from 1.8 percent of GDP in 2007 to 7-8 percent in 2009-10. This increase was higher on average than in recession-hit euro zone economies, which often had to bail out their banking sectors. And so in much better circumstances, Mr Tusk has allowed the budget deficit to swell significantly.

Much has been made of the middle-income trap threatening Poland. What can be done to avoid it?

This trap will become reality if the rate of growth in Poland is not 4 percent per annum but remains at about 2 percent. At a level of some 60 percent of the average GDP levels in the richest countries, the catch-up process sometimes comes to an end. Unless something is done to support it, a country will enter the middle-income trap. For example, the Czech Republic, which is more developed than Poland, seems to have entered that trap now. So has the eastern part of Germany, southern Italy and northern England.

I already noted that too few people are economically active in Poland. In Poland B, as well as in agriculture in general, there is a fairly large unemployed and underemployed labor force. Up till now Poland’s contribution to technical know-how in the world has been close to zero. We have been growing relatively fast thanks to a transfer of technology from the West, but from now on we will have to rely on our own innovative solutions to a greater extent.

We need better universities, more efficient research centers, increased FDI. We need to be more integrated with the most advanced economies. Joining the euro zone would help, as it would increase competition while eliminating the exchange rate risk in trade and investment projects.

Ultimately though, we should realize that we may never eliminate the gap between Poland and western Germany. The growth slowdown is ultimately inevitable for us. We could postpone it somewhat, but that would take a lot of mobilization in terms of policies, institutional reforms, eliminating the various barriers which companies now face. However, if we were to achieve a level of 80-90 percent of German GDP per capita, that in itself would be a big success.