

The future of Poland's debt: productivity or default?

by Renée Sigerson

If Poland is ever to pay back the nearly \$27 billion it owes to Western government agencies and commercial banks, then productivity and an ensuing capacity to generate foreign exchange earnings will have to be restored to the Polish economy. The strange twist this simple fact has produced is that Poland's Western creditors—if they ever want to see their funds again—are now politically dependent on the success of the Brezhnev faction in the Soviet Union in defusing the economic program demands of the Solidarity/KOR movement, and in reintegrating Poland into Comecon programs for economic development.

Sometime around March 15, at the height of the Warsaw Pact military maneuvers on Poland's borders, Poland halted payments on its debt to Western commercial banks. On March 31, commercial bank representatives from the four leading creditor countries had an emergency session on the cessation of payments in London. On April 9, Western government representatives convened in Paris to discuss "rescheduling" for the \$4.4 billion in Poland's official debt. The commercial bankers meet again in London on April 15.

What overshadows these meetings is that a certain myth which had been generally granted by Western financial officials for the past eight years has been rudely dispelled. The myth is that the Soviet Union extends an "umbrella" over all Comecon country debt, in order to protect its own "credit rating."

In mid-March, what the Soviet Union communicated by refusing to bail out Poland was that its umbrella is not its willingness to unconditionally perform as a lender of last resort, but is a political umbrella defined by its commitment to solve Comecon economic problems in a rational way.

Highly contradictory and incomplete reports are currently circulating in most of the Western press about the circumstances that forced Poland to cease payment at the height of the Soviet maneuvers.

Review of the available facts on how Poland evolved from a crisis-ridden country into a flat-broke bankruptcy case has led *EIR* to the conclusion that the highest-level

Soviet leadership included in its calculations of how the U.S.S.R. could respond to the Polish crisis the fact that the Soviets had the power to determine the *timing* of a major international debt default.

Chronology of bankruptcy

Naive U.S. government officials are circulating the line that it was "obvious" Poland would run out of money due to political instability. In interviews with informed sources this week, it emerged that bankers and strategic think-tank advisers disagree.

Until September 1980, Poland—which ranks third among indebted countries internationally in size of total debt—was far from bankruptcy. Financially, what it suffered from was an ingrained cash-flow problem.

Poland's cash-flow squeeze dates back to a 1977 top-level meeting held by the Bank for International Settlements in Basel, Switzerland, where oligarchical financial circles outlined a credit policy for Poland deliberately aimed at fostering economic conditions which would aid the emergence of the radical Solidarity/KOR currents. Poland's debt at that time was somewhat over \$13 billion.

This level of indebtedness had spiraled in a three-year period, coinciding with the 1975-76 Western European recession induced by the first oil shock. Prior to 1975, Poland had one of the fastest growing economies in the world. From 1973-75, industrial output was rising at over 10 percent annually, as the Gierk government used foreign exchange earned from coal and food exports to import new generations of industrial technology. Increasing levels of indebtedness to Western banks were used to finance these capital imports when Western recession put a ceiling on earnings generated from exports.

Polish chief Edward Gierk allowed indebtedness to rise by \$10 billion between 1973 and 1977—\$6 billion of that arising after 1975.

At the 1977 BIS meeting, it was decided to use the rapid increase of Poland's foreign debt to drastically lower Poland's credit rating. Interest margins were set

at the same rates paid by the "poorest risk" Third World countries (like Egypt), and Poland was denied any loans for debt consolidation. Combined with historically low agricultural productivity, the lending constraints began to slice away at industrial growth. In 1978, industrial output grew only 4.9 percent, in 1979 only 2.1 percent.

It was precisely at this time that international financial circles began publicly circulating the myth that the Soviets would have to guarantee East bloc debt to the bitter end to protect their own credit rating.

As Poland began to suffer from cash-flow problems, in January 1980, the French government gave Warsaw a generous loan guarantee to alleviate the temporary cash-flow strain. In September 1980, German banks lent Poland \$500 million, just before Gierek was toppled.

Since Gierek's fall, Poland's economy has gone through an extremely rapid devolution. Industrial output in the first quarter of 1981 was 10 percent below last year. Exports to the West fell 27 percent in January/February, and 29.3 percent in March. Hard currency imports of oil fell 80 percent during the same months. Recently, Polish consumers found nothing but bottles of vinegar and cans of peas on the shelves of grocery stores when they tried to purchase food.

The rapidity of the economic downturn, observers have emphasized, is due not so much to loss of work days in the strikes, but rather to the extreme effect which shortages in Poland induce in the Comecon as an economic unit—forcing the rest of the East bloc to impose selective "embargoes" against Poland. A late March Radio Warsaw broadcast explained with precision the chain-effect which goods bottlenecks in Poland produced throughout Comecon:

Inflation is beginning to get out of control. . . . We cannot count on offsetting . . . scarcities through imports. . . . We can count on the fraternal help of the countries of our community, but we must realize that our failure to meet export obligations causes very serious troubles for our partners. . . . The lack of deliveries from Poland forces them to make purchases on hard currency markets. . . . Our neighbors must therefore obtain hard currency assets by selling the capitalist countries, sometimes on unfavorable terms, those goods which were earmarked for Poland.

It is now known that during the last months of 1980 into mid-March 1981, the Soviet Union was financing Poland's debt payments. With the exception of some loan guarantees from the U.S. Commodity Credit Corporation, specifically linked to agricultural imports and therefore not free to finance general account payments, by January, Poland was bankrupt. In mid-March, the Soviets then snapped the "umbrella" shut.

Astonishment—quickly hushed up by the press—passed through Western financial circles. A specialist at the Council on Foreign Relations in New York admitted the Soviets were "putting pressure on Western governments by not bailing the Poles out." The *Neue Zürcher Zeitung*, Switzerland's leading financial daily, suggested that maybe the Soviets would start paying again—after a successful invasion of Warsaw. Germany's commercial daily *Handelsblatt* warned that saving Solidarity/KOR might necessitate a full-scale debt moratorium.

Financial miscalculation

The banking circles that set out to undermine the Gierek industrial program beginning in 1975-77 acted upon what has turned out to be a strategic miscalculation. As a result, at the present moment, the Soviets have an upper hand on the debt rescheduling talks underway.

First, the BIS et al. misestimated the *rate* at which economic devolution in Poland would affect foreign-exchange reserves throughout the Comecon. The mis-evaluation is revealed by a recent series of simplistic items in the British media about how the Soviets have "gotten rich" from gold, diamonds, raw materials and oil sales rigged in collusion with South Africa. British "wishful thinking" about the Soviets' "hidden" ability to bail out the Comecon has gone so far that this week, BBC television had a special feature broadcast on secret Soviet-South African financial ties.

Second, the oligarchical financial networks underestimated the commitment across Europe—especially by the Soviets, West Germany, and France—to push into implementation phase a program for continent-wide industrial capitalization based on energy cooperation. With \$7.5 billion in outstanding commercial loans, German and French banks are Poland's largest creditors. The same banks are currently negotiating over \$5 billion in loans to the Soviets to begin purchases of Western technology for construction of a gas pipeline from Siberia to Western Europe. German industrialists report that the loan talks are "going very well."

Two basic proposals are reportedly on the table for rescheduling Poland's debt. One would give Poland a 6-month grace period, subject to "ad hoc" renegotiation every 6 to 12 months following. The other would extend the grace on interest payments to at least 2 years, and rework maturities for 10 years. The latter, rumored to be backed by France, would obviously be more "generous" in giving Poland a chance to return to 1970s peak rates of growth. More important, though, than the terms of repayment is recognition by all parties concerned that if Solidarity's program of economic devolution continues, the West can write off its loans for good.