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Poland's Economy in the 20th Century – Turning Points and Challenges*

Bence Varga

Zbigniew Landau – Jerzy Tomaszewski:
The Polish Economy in the Twentieth Century
Croom Helm Ltd., London & Sydney, 1985, p. 360.
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In May 2022, the Central Bank of Hungary (Magyar Nemzeti Bank) published a comprehensive programme proposal entitled Sustainable Balance and Convergence in 144 Points[1], which details a two-year economic stabilisation programme. One of the points made in the discussion paper is that the Hungarian economy has unfortunately deviated from the Polish path of development, as shown by the imbalance. Although the comparison in the discussion paper refers to the recent past, we think that it may be worth briefly reviewing the development of the Polish economy in the 20th century, based on the book by the two distinguished Polish academics *Landau* and *Tomaszewski*, in order to see what path the Polish economy followed in this period and what lessons can be drawn from it for today.

After more than 100 years of fragmentation, the Second Polish Republic, which was created after the Polish state became independent (1918), had quite large differences in development between the various parts of the country as well as different legal systems, which meant that they had to be brought into the public finances by completely different means. One of the most important challenges for the Polish government was the revitalisation of industry, for which the government provided loans and orders to entrepreneurs, but the orders could not always be considered necessary for the country's economy and the loans were often insufficient (e.g. the textile industry in Łódź could only develop substantially with loans from the Entente countries). In addition, there were considerable shortages of several raw materials (e.g. coal; in 1919, for example, only 35 per cent of the coal demand was available from within the country's borders). The war economy

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Bence Varga is a Senior Supervisor at the Magyar Nemzeti Bank and a Researcher at Budapest Metropolitan University. E-mail: vargabe@mnb.hu

[1] https://www.mnb.hu/letoltes/fenntarthato-egyensuly-es-felzarkozas-144-javaslat-20220519.pdf

momentarily boosted industry – later, however, this proved to be a temporary effect – but industrial output did not reach the level of 1913, despite the increase. Despite the shortage of raw materials and labour, private enterprises benefited from this period mainly in the form of investment financing, the establishment of private factories and new industrial plants (e.g. electrical industry, precision and optical industry).This was also largely due to accelerating inflation, which allowed production costs to fall in real terms (i.e. the cost of credit was not valorised until 1923), and the cost of transporting goods to decrease (though they increased in nominal terms, but much less than inflation). From 1918 onwards, joint-stock companies developed rapidly, with some 1,455 such companies (e.g. related to sugar refining and textile industry) set up in the first five years after Poland's becoming independent. There was also a need to stabilise the banking system, as a very large number of banks were established (their number increased from 16 to 111 between 1913 and 1923), and the saying of the time was *"if you are in financial difficulties, start a bank"*. Most of these banks were involved in dubious deals and were mostly considered unviable. However, as inflation later accelerated, these unviable banks failed, while most of the systemically important banks (e.g. Bank Handlowy w Warszawie) were saved by state capital injections.

In 1922, the annexation of the eastern part of Upper Silesia to Poland brought several positive benefits (e.g. the supply of raw materials or the conclusion of trade agreements providing for duty-free access), and although there were initial concerns about the Polish market's ability to absorb supply from Upper Silesia, these were later proved unfounded because of the rising inflation and increased demand, due to the French occupation of the Ruhr area. Initially, the creeping inflation had a positive effect (e.g. tax revenues increased), but later, when inflation started to run out of control (from 1923), only the negative phenomena remained: wage inflation reduced domestic demand, production fell, unemployment increased, and the growing public deficit meant that the state did not create additional demand, and the possibilities of borrowing abroad were reduced. However, unlike the 1929–1933 crisis, this was mainly due to internal causes (e.g. rising inflation due to budget deficits).

The period between 1924 and 1929 can be divided into two parts, the inflationary crisis of 1924 to 1926 and the period of economic growth of 1927 to 1929. The first period was characterised by social impoverishment, unemployment as well as falling consumption and investment. In the second period, there were already positive trends, with the application of farming techniques that could be considered modern and the introduction of a land reform, which were clearly positive changes. Industrial production in 1929 was 21 per cent higher than in 1923 (but still only 91 per cent of the 1913 level), helped also by the 1926 British miners' strike through increased coal exports. This period also saw a change in the structure of industry, with the mining and textile industries dominating the sector, but by 1929 food processing and construction also took on a greater role. There was also some degree of modernisation in industry, with some of the basic steam engines being replaced by electric or internal combustion engines. Numerous attempts were also made to reduce the budget deficit, including by cutting government expenditures and introducing various forms of taxation (direct and indirect taxes, e.g. property tax, land tax, increased income tax), so that by 1927 the budget was already as planned. Monetary reform was completed in 1924, when the Polish zloty replaced the earlier Polish mark. However, the stabilisation was accompanied by substantial foreign borrowing, which in many cases was excessive and quite expensive, and by the granting of various privileges that could not be justified (e.g. Italian businessmen also secured raw tobacco products for a loan of 400 million lire, on terms that could not be considered very favourable). Stabilisation of the Polish currency contributed to the consolidation of the capital position of the banks, and public confidence in the state banks increased in contrast to the private banks, which in many cases performed speculative activities as well (some of which even went bankrupt), which led to a reduction in the number of banks from 111 in 1923 to 51 in 1929.

The years between 1930 and 1935 were the years of the Great Depression in Poland as well, with the crisis hitting bottom in 1932. The following few years were more of a period of stagnation. Poland was hit harder by the crisis than other European countries. For example, while industrial production in Germany decreased by 53 per cent, it fell by 58 per cent in Poland. The recovery after the crisis was also slower than in other countries, so while Polish production in 1935 was 76 per cent of that in 1928, in Hungary, for example, it was 113 per cent. The reason for this in a large part was that the crisis caught the Polish economic policy completely off guard; even in the year before the crisis began, a large number of Polish economists predicted an economic recovery and even when the crisis hit, only a temporary, short downturn was forecast, so that no major assistance to industry, agriculture (where the downturn was one of the most significant in the developed countries) or the banking sector was envisaged. Unfortunately, monetary policy was also characterised by a belated reaction, with no desire to impose exchange rate or payment restrictions, leading to an outflow of foreign capital and depletion of the gold and currency reserves of the Polish central bank, *Bank Polski*. The aim was to reduce the budget deficit by reducing expenditures (e.g. education, agriculture and pensions) and increasing revenues (mainly through tax revenues, selective tax policies and by introducing income tax). However, even in the short term, these measures proved insufficient, and the longer-term effects (e.g. on education) had even more serious consequences. In 1931, within a few months of the news of the collapse of the Vienna Creditanstalt, almost half of the total deposits were withdrawn from the banking sector, but the state banks were more trusted by both the domestic and foreign investors and even saw their deposits rise. The crisis was exacerbated by the fact that Bank Polski kept its base rate high (one of the highest in Europe), further restricting the already tight lending.

The years 1936–1939 also saw an improvement in the situation of Polish agriculture and industry through an improvement in the general economic climate. The Polish government's aim was to make the economy independent of foreign countries, and in 1936 it drew up a four-year investment plan, but it was rather under-coordinated and difficult to implement. However, instead of a projected 1,800 million Polish zloty, 2,400 million Polish zloty was spent on investment (mainly on modernising industry and developing economically backward regions), which also contributed positively to job creation. The 4-year investment plan was followed by a longer, 15-year investment plan (1939–1954), which was only partially implemented due to the later outbreak of the World War. During the period of the German occupation (1939–1944), industrialisation gained new momentum, but unfortunately it was less organised (especially in the early years of the occupation) and mainly focused on the German Reich's interests (i.e. war aims). Accordingly, the weight of light industry was significantly reduced (small private enterprises were liquidated or merged), many factories were closed without compensation, and a number of enterprises were assigned to a so-called trustee (Treuhander), who essentially exercised the ownership rights. Total industrial output fell most sharply between 1938 and 1941 (by 63 per cent), and although there was some improvement later, in 1942 it was still only 60 per cent of the 1938 level. The only industries that grew during this period were those serving the German army, and agriculture, also in the interests of the German Reich (i.e. providing its food supply). Unfortunately, the increase in agricultural output was not accompanied by the introduction of modern techniques, and in many cases not even by an increase in the area under cultivation, but rather by the more intensive use of existing land. The tax system was characterised by a higher contribution of Polish citizens compared to Germans, as Polish residents had to pay a special tax (the so-called Polish contribution and a social compensation tax, which in some areas amounted to 15 per cent of the salary), while earning 10–30 per cent less than German residents. Through monetary policy, Polish society also suffered a negative turn of events, with a loss of around 75 per cent due to the conversion of the Polish zloty and the German mark, and even a limit on the maximum amount of mark that could be exchanged. Before the German invasion, Bank Polski had all the equipment needed to print money, together with the gold reserves, shipped abroad, so the Germans set up a separate banknote-issuing institution called *Bank Emisyjny w Polsce*. Bank Polski was based in London during the occupation years and was preparing for normal post-war business during this period.

After World War II, the recovery of industry was relatively quick, as the power plants and water networks were not damaged, but it was not an easy task due to the shortage of skilled labour and raw materials, and was one of the major challenges of the period, along with the restoration of agriculture and the implementation of land reform (by 1946 industrial output was about 70 per cent of its 1938 level). From the Soviet occupation (1944) onwards, Poland followed similar trends to the other occupied countries: the period was characterised by nationalisation (87 per cent of the workforce was employed in state-owned enterprises by 1947, with this figure rising to 89 per cent by 1949), central control, centralisation, forced industrialisation (a 6-year and then a 5-year plan to develop heavy industry) and the creation of cooperatives. Initially, during the years of occupation, there were several types of banknotes of 3 or 4 different denominations in circulation, apart from zloty also from the occupied territories, and the German mark and Soviet rouble were also accepted currencies. *Narodowy Bank Polski* was set up on 15 January 1945, primarily to stabilise finances, centralise the management of company accounts and issue new types of zloty banknotes.

From the second half of the 1950s to the 1970s, the Polish economy gave priority to the search for equilibrium in order to improve the quality of life and prevent the rise of unemployment. The latter was a growing problem due to population growth after the Second World War, as this age group had reached working age (which is why, unlike many other countries, Poland did not have a labour shortage at that time). The need for economic reform became apparent to the Polish leadership, and several initiatives were taken, but unfortunately they did not succeed. One such initiative was the Economic Council, established in 1957, which, although headed by renowned economists, with *Oskar Lange* as its president and *Edward Lipinski* and *Michal Kalecki* as its vice-presidents (the latter was nominated for the Nobel Prize), was nevertheless dissolved in 1962 for its diminishing role and lack of meaningful activity. Although the period from 1957 to 1970 saw an increase in industrial output (by 1970 output had more than tripled compared to 1956), this was not accompanied by any significant modernisation of industry or improvement in product quality. Initiatives were taken in this direction, but a long-term economic strategy was still not developed. Social discontent eventually led to an uprising on 17 December 1970, commemorated by the Gdańsk Fallen Shipyard Workers’ Memorial, which has since become a symbol of the Polish port city.

The Agricultural Development Fund, established in 1959, was of great importance for the development of agriculture, and its funds could be used for mechanisation and modernisation, for example. However, use of the Fund’s resources was rather limited, so there was no possibility for indirect development (e.g. infrastructure), which would have been particularly needed in the agricultural sector as well. By the second half of the 1960s, agricultural output accounted for 16 per cent of total output, up from around 10 per cent earlier, partly because the government was already encouraging investment in agriculture at this time. Despite this, the general mood towards agriculture could not be boosted. The fact that health care was not free for agricultural workers (only from 1972), that accident and old-age insurance was not available to them, and that there were no adequate lending sources available, may have contributed to this. The number of people working in agriculture was declining and they were ageing, with a consequent increase in the proportion of land that was not properly managed. There was a proposal by the Polish government to take over land from ageing agricultural workers in exchange for an old-age pension, but, on the one hand, this was not popular with the population and, on the other, because of the problems mentioned above, without a meaningful modernisation of agriculture, the state takeover would also not have substantially helped to increase agricultural output.

The period from 1971 to 1980 was a period of accelerated development in Poland. In 1971, a new 5-year plan was announced, which also aimed to improve the quality of planning and organisation, in the light of previous negative experiences. The plan's priority was to improve living conditions by increasing real wages (by 20 per cent) and national income (by 38 per cent). In addition, a substantial increase in industrial and agricultural output was also included in the targets through an increase in investment (with the allocation of 1,900 billion Polish zloty). Among other things, this led to the establishment of a new coal mine in Lublin, the development of infrastructure (both roads and railways), the development of the northern port of Gdańsk and the establishment of a steelworks in Katowice as well as the launch of car production in Bielsko-Biała (under licence from Fiat). However, there were also a number of negatives, such as the inadequate development of the railway network, and the choice of location for the Katowice steelworks was not the most expedient based on subsequent experience. Also, the factories took too long to set up, resulting in an unduly long commitment of capital. The level of development that occurred exceeded the country's capacities (e.g. in terms of raw materials and labour), necessitating the complete halt or postponement of several investments, and, as in previous years, in many cases quantitative aspects took precedence over qualitative ones, while imports for the investments contributed significantly to increasing external indebtedness and thus vulnerability. The world economic recession of the late 1970s, the resulting shortage of raw materials, mounting inflationary pressures, inadequate levels of investment in agriculture (in the first half of the 1970s investment even decreased compared to the previous years) put the Polish economy in an extremely unfavourable situation, which could not be changed even by the 1976 turnaround, called the economic policy "manoeuvre". By 1980, the budget deficit had reached a level not seen in the country since the Second World War. The Polish economic crisis had a specific character because, unlike the Great Depression of 1929–1933, the Polish crisis of the 1980s was not an imported crisis, but the result of the country's own flawed domestic economic policies.

A review of Poland's economy in the 20th century can provide a number of lessons: public funding (whether direct or indirect) is very difficult to sustain in the long term, at great social cost, and the emphasis should be on promoting self-financing. In this context, there may also be a moral hazard, whereby economic operators anticipate public resources, deliberately placing insufficient emphasis on increasing their self-financing capacity. The lack of strategic planning and coordination in Polish economic policy was exposed on several occasions in the 20th century, and the Polish government responded by introducing unprecedented tax measures, cutting pensions and education spending as well as other cuts, with a focus on short-term goals. The latter was also reinforced by delay of a meaningful modernisation of industry and agriculture. It is striking how unexpected the 1929–1933 global economic crisis was for the Polish economic policy, and why the government's actions in the early period of the crisis were characterised by "denial". But we should also be self-critical about observing the development of the Polish economy in the 20th century, because – to return to the initial thoughts – Poland remained only temporarily on this unfavourable economic path, though it took many years, and looking at the current equilibrium processes, we must say that Poland, albeit painfully, has learned its lesson.