The Balance of Payments in the Second Republic of Poland

Grzegorz Wójtowicz

The aim of this paper is to present the first ever study of the balance of payments in the Second Republic of Poland.

The balance of payments in the inter-war period strongly indicates the degree of complexity of the conditions with which the Polish economy was faced. War to secure the country's borders, hyper-inflation, currency reform and immediate destabilisation of the Polish zloty, followed by the stabilisation of the currency and a short period of fast growth facilitated by the inflow of foreign capital, another serious economic depression and capital outflow, and finally the introduction of foreign currency monitoring accompanied by the economic growth enhanced by the intervention policy – all determined the evolution of the economy, the balance of payments and the balance of the stock of external financial assets and liabilities.

The key element in current operations was the export of goods and commodities. This was relatively low and ineffectual. During the period of enhanced growth, exports were much lower than imports, which caused a substantial trade balance deficit. The depression, and then the period of foreign currency purchases controls were both characterised by a strong tendency to balance import/export levels, or even to reach a trade surplus, despite capital outflow.

Services were of secondary importance, yet it should be noted that here the balance usually was positive. Until the mid-twenties, the relatively high surplus, due to huge transfers from emigrants, was even higher than the deficit on the income side, i.e. yields on capital inflow. Then the situation was reversed.

These trends in current transactions usually resulted in a negative balance, with a few exceptions, in the twenties, whilst the thirties witnessed small surplus amounts. A reverse trend was noticed in the financial account. Until 1929, it had been positive as a result of capital inflow, thereafter, with the capital outflow, it became negative.

Large notional amounts of money in the balance-of-payments had their source in errors and omissions. To some extent they resulted from deficiencies in the statistical methods of the time. In some years, large amounts of money meant undisclosed income resulting from the private hoarding of gold and foreign assets. In some other years, as a result of buying-in carried out by the issuing institution, these values augmented reserves.

The reserves of the issuing body experienced serious fluctuations. They reached their peak level at the time of statutory stabilisation of the zloty in 1927. Then, after the period of continuous decrease in reserves, which were used to maintain the balance of payments in the following years, the stability of these reserves was restored with the introduction of foreign currency controls in 1936.

The comparison of the stock of external financial assets and liabilities showed a stable and considerable predominance of foreign capital. It reached its peak just before the great depression and gradually diminished in the following years, to reach the level of the mid-twenties. Political events, economic trends and currency instability determined the direction of the capital movements – its inflow or outflow. In the years 1918 – 20, and 1936 – 39, Poland, for political reasons, was given loans mainly to improve its military forces. The loans granted in the years 1924 – 25 and 1927 – 29 were connected with the stabilising of the currency and with the positive trends that followed this stabilisation. It should be noted, though, that during the unstable inter-war period Poland was perceived as a country interposed between Russia and Germany, which meant higher investment risk. The balance of payments in the Second Republic of Poland seems to confirm this bitter reflection.

Exchange rate regimes and Poland's participation in ERM II

Jakub Borowski, Michał Brzoza-Brzezina, Piotr Szpunar

In this paper the authors address some of the issues resulting from Poland's will to join the Economic and Monetary Union. Their attention focuses on topics related to the possibly soon entry into the European exchange rate mechanism (ERM II). They consider the possible paths of entering the system, providing a detailed analysis of the choice of fluctuation margins and the central parity.

Further, the authors analyze the possible monetary policy strategies within the system. They describe the benefits and drawbacks of ERM II participation and consider the eventuality of parity revaluation. In this part estimates of the Balassa-Samuelson effect for Poland are provided.

Cyclical economic trends versus changes in real exchange rate

Michał Kruszka

One of the economic factors which should influence the exchange rate of the currency of a country is the position of its gross domestic product as compared with GDP of another country. Models favouring flexible prices and those opting for strict price control anticipate that this kind of relationship entails real depreciation of currency at times when the GDP of a country is relatively high.

This study aimed at verifying the above conclusion, using statistical data for the economies of Australia, Japan, France, Canada, the United States of America, Great Britain and Italy. In each case, the phenomenon was analysed on the basis of the estimated real exchange rate of an individual currency against the American dollar. The second variable in this study was the value showing the relation of GDP *per capita* in fixed prices to a parallel aggregate for the USA.

The results show that it is hard to establish simple and direct correlations, yet the intensity and duration of relative changes in the value of GDP significantly strengthen the relations between the values analysed. It is worth mentioning that the time criterion proves to be of greater importance in this instance. Therefore, it may be concluded that when the increase in economic activity reaches a level well above its long-term average and lasts for several consecutive quarters, the real depreciation of the currency of the country becomes perceptible. Hence, an empirically verifiable relationship between the valuation of a currency and the shaping of the cyclical trends can be observed.

Impacts of regulatory discipline on market discipline in banking

Krzysztof Jackowicz

Recent developments in the banking sector such as consolidation, geographical expansion, new product ranges, the growing complexity and variety of the financial instruments issued and purchased by banks have been increasingly exposing certain inadequacies in the regulatory arrangements, whose inherently static nature is particularly apparent during crisis situations, thus creating pressure to step up efforts to strengthen market discipline in banking. Rather than abandon the regulatory discipline, however, virtually all countries have opted to improve regulatory measures and the prospect of a permanent coexistence of the regulatory and market disciplinary mechanism is becoming a fact of life. The two systems not only co-exist, but also influence each other. The paper is based on published empirical research and aims to identify and discuss the areas where the regulatory discipline influences the market discipline.

Firstly, it emerges that supervisory activity has a beneficial effect on the quality of financial statements. The supervisory bodies not only review the finished product but also inspect banks during the drafting stages of financial statements. In a majority of cases regulatory discipline mechanisms have revealed figures showing poor aspects of the financial situation of banks. The necessary corrections tend to be considerable and investors, in their pricing of stocks, take advantage of the information that was included in the financial statements resulting from supervisory activities. More reliable financial statements mean that investors are in a better position to monitor the banking sector and to influence management policies in a more precise way.

Secondly, empirical research has hitherto been unable to answer the question as to what extent such assessments of banks' condition by supervisory bodies are important to investors. In those rare cases when supervisory ratings have been disclosed indirectly, the investors' reaction was influenced not only by the new information, but also took into account the anticipated response of the supervisory bodies.

Thirdly, there are two ways in which market discipline mechanisms restrict the scope of the market to influence the banking risk. Banks can alleviate market pressure by increasing secured deposits in their financing structure. Additionally, bank management is far less exposed to the direct disciplinary pressure experienced by non-financial sectors in the form of hostile takeovers and shareholders' actions, which in the banking sector are largely substituted by supervisory interventions. From the point of view of market monitoring, the co-existence of regulatory and market disciplines causes the markets to reflect not merely the condition of a given bank, but also the ramifications of having the deposit security system in place, the existence of the presumed safety net for the largest corporations and the predicted extent of the supervisory intervention.

In summary, the effect of regulatory discipline on market discipline must be seen as a mixed one. Indeed, we seem to be seeing both complementary and contradictory effects of regulatory and market disciplines.

The impact of the economic condition and general systemic solutions on the development of the Polish capital market and the investment banking sector

Dariusz Piotrowski

The author deals with capital markets and investment banking in Poland. He adopts a broad definition of an investment bank that includes brokerage houses active on the financial markets. The Polish capital market is currently going through a bad period, which is best illustrated by the financial performance of brokerage houses and the investors' mood. Indeed, this segment of the financial market has been in difficulty since the second quarter of 2000. There are a number of explanations for this situation and the author has identified the major causes of the capital market slump. The original legal regulations for the capital markets were too restrictive. While, on the one hand, this 'over-regulation' protected the young market from the dangers of unequal investor treatment, on the other brokerage operations were excessively restricted and the market was unable to develop freely. Subsequent governments used the stock exchange principally as a tool in the privatisation process. They overlooked the opportunity to promote the capital market among small and medium sized enterprises and there are insufficient new listings at the moment. Difficulties of the Polish economy, global economy stagnation and accounting scandals are all reflected by the securities market. One can only hope that, as the condition of Polish companies improves and legal regulations expected by the market are put in place, there will be a revived interest in trading on the Warsaw Stock Exchange.

An economic quality model in banks

Janusz Kudła

During recent years, several research projects have been launched on commercial banking quality. Sadly, there still is no cohesive economic model presenting the relationships between the quality of services and the resulting financial performance. This paper shows an attempt to build such a micro-economic model working in conditions of imperfect competition, asymmetrical information and the existence of transaction costs. The model presented clearly explains many phenomena characteristic of the varied levels of service quality in the sector.

What is being stressed is the impact of the higher quality on revenues. Basically, the benefit of offering quality service lies mainly in building a monopolistic power that may be exploited in the form of tougher, but still acceptable pricing conditions. The relationship changes depending on whether we are looking at data from a static or a dynamic point of view. In the latter case, the level of quality changes the competitive price conditions to favour banks offering higher quality. On the other hand, profits can be increased on the cost side by service standardisation, which, however, only makes sense for smaller customers; larger customers will continue to demand a more individual approach.

Electronic banking in the European banking systems: Finland

Tomasz Chojecki, Anna Matysek

Without doubt, Finland has been one of the Europe's pioneers in using advanced information and communication technologies in many economic processes. This has also had a large influence on the whole banking system. Therefore, due to their ability to skilfully and successfully adopt to the ever-changing economic conditions and because of the growing competence of society in using information technology, Finnish banks have become leaders in the use of the modern technology in providing financial services.

The changes which have been taking place in the Finnish banking system for the last decade have resulted from banks' conscious actions or even co-operation and from their attempts to meet customers' needs. Obviously, economic factors (reflected in macro-economic conditions in which the economy functions), as well as legal and organisational aspects have also played their role. The use of electronic channels of distribution have enhanced and dominated Finland's modern banking system. The continuing abandoning of the traditional banking infrastructure, which is being replaced with modern electronic one, has made banking services available to customers, regardless of time and place.

The increasing application of electronic operations in payment system, the growing number of customers interested in electronic services, together with the improving financial status of banks justifies the conclusion that Finnish banks have taken advantage of the development and use of advanced technologies in providing services. It should be remembered, however, that the success of the Finnish banking sector was not accidental, but resulted from long-term joint activities by institutions engaged in the process of shaping of the Finnish banking system.