Chapter 9

The stabilization in Poland: the battle of zloty

9.1) Introduction

This chapter concerns the final episode of the Polish stabilization or the process by which the exchange rate was maintained fixed. We discussed somewhat extensively in Chapter 7 the dissemination of indexation in Poland, so that we know that by fixing of the exchange rate the hyperinflation is stopped almost simultaneously by the indexation/dollarization mechanism. We know from Chapter 8 that the stabilization in itself solved most of the fiscal problems observed during the hyperinflation and that it reduced the fiscal deficits to quite manageable levels. For the Polish case in particular, it was shown in Chapter 8 that an expansionary fiscal policy was actually implemented. We suggested in Chapter 6 that the basic incompatibility between external balance and the desired level of wages would seem to be solved by "improvements" in Poland's international position accomplished during the inflation period and by borrowing abroad. This chapter is mostly addressed to examine the effort of fixing and sustaining the exchange rates, which was what actually stopped the hyperinflation; but we also discuss briefly the nature of the latter improvements and especially the part they played in the stabilization effort .

Polish historians often emphasize the fact that the stabilization was accomplished by "the country's own efforts"[1] meaning that it did not involve foreign financial help. Though not entirely true the contrast between Poland's access to foreign finance and Austria and Hungary is very significant. The Poles had been very reluctant to adopt the Brussels recipes and had been decisively determined to avoid a League Scheme. That was in part a very characteristically Polish manifestation of national pride that was quite understandable at the circumstances surrounding the Polish independence. But more importantly it reflected the priority assigned by the Poles to their structural adjustment needs and its implied investment expenditure. This represented clear contrast with Austria and Hungary, but policy endeavors as such mean nothing if the objective conditions allowing such choices are not present. In this connection, the decisive factor in creating an alternative course of action was the annexation, or the reintegration, of Upper

[1] Z. Landau & J. Tomaszewski(1984) p. 272.

Silesia in 1922; this represented a significant and "permanent" improvement in the country's international position. Upper Silesia improved considerably the perspectives for a stabilization effort, but the annexation took place almost simultaneously with the collapse of an orthodox stabilization attempt so that the timing favored the use of the newly gained capacity to import for investment purposes.

The Polish stabilization of January 1924 differed in many respects from the Austrian and Hungarian. One significant difference was the choice of parity rate, for by choosing the market rate or above, less reserves would be required at first, according to what was argued in Chapter 5. Another difference was the character of financial policies, that we saw in Chapter 8 to have been expansionary, and yet another was the resort to foreign financial help in a smaller scale and from "peripheral" financial centers. A very significant contrast was the fact that Poland started the program on top of significant trade surpluses, so that even by establishing a parity rate that would create wage pressures and a deterioration of competitiveness, the Poles could hold the line for a significantly long period of time. In fact the latter threats did materialize and it is significant that even with bad crops, very liberal commercial policies and, more significantly, with a set-back in their attempts to reenter international capital markets, the Poles managed to resist for well over an year. The specter of the hyperinflation was no longer there when the zloty was allowed to float in 1925, but this time a recession and restrictive commercial policies had to be implemented at least until Poland could finally regain access to international credits by contracting a large "reconstruction" loan in 1927.

This chapter is organized as follows: the next section examines the contrasts in attitude and policy alternatives between Poland and Austria and Hungary , and it also discusses briefly Michalski's stabilization attempt. Section 9.3 discusses Grabski's plan and the factors and circumstances responsible for its success and the "second round" of the stabilization, or the wage determined deterioration in competitiveness and its consequences are examined in section 9.4. The last section draws conclusions.

9.2) Stabilization, investment and the loan issue

Foreign financial help was a recurrent preoccupation of the Polish authorities throughout the 1920s. The first finance ministers of the new Poland strongly emphasized the necessity of foreign capital to help establishing the new state, but little could be done on this account this early. With the start of the war against the Soviet Union, the Polish government managed to receive financial aid from the Allies in substantial amounts, though mostly on the form of commodity credits. The amount of aid totaled the amount of 272 million dollars during the 1918-20[2], an amount of the same order of magnitude of the total value of Polish exports during this period. After the war the Poles renewed efforts to procure foreign loans, but at this time for reconstruction, investment and stabilization purposes, in this order of importance. No more than US$ 15 million could be obtained abroad in the next three years; an eloquent indication that these Polish priorities did not seem to match those established at Brussels. In any event, after demobilization, Poland seemed ready for the first serious stabilization attempt.

In the end of 1921 a cabinet of experts with professor Michalski as Finance Minister, was commissioned to undertake the stabilization of the currency. Michalski's episode seemed a mirror reflection of the Hegedüs experience in Hungary. The budget was balanced with the help of a capital levy, the Treasury's indebtedness with the Central bank was maintained constant from November of 1921 to June of 1922 and the exchanges were roughly stabilized[3]. Inflation was not stopped, however, prices increased by 2.5% in December and in the next three months rose 3.8%, 7.1% and 15.8%. As in the Hegedüs episode the wage pressure was the origin of these price increases, as seen in Table 9-1. Despite the sharp increase in unemployment[4] simultaneous with the plan's implementation workers made significant gains especially during the first months of Michalski's plan when inflation was under control. The resulting deterioration in competitiveness, on top of an already delicate payments position, and absence of any help from abroad eventually produced the collapse of the plan and Michalski's resignation in June.

---

[2] Z. Landau (1974) p. 287.
[3] G. Zdzichowski (1925) pp. 6-7.
[4] Z. Landau (1967) pp.192-198, ILO (1925) pp. 115-116,175 and J. Szturm de Sztrem (1924) p. 396.

Table 9-1
Poland: Real Wages and Real Exchange Rates during Michalski's Tenure
(January 1914 = 100)

	Date	Real Wages[1]	Real Exchange Rates[2]	
1921-	Setember	88.9	-	65
	October	91.6	-	58
	November	99.1	-	71
	December	100.3	-	75
1922-	January	101.1	81.5	81
	February	98.5	76.9	76
	March	100.9	86.7	73
	April	93.5	93.7	83
	May	96.9	95.8	82
	June	93.7	95.5	87

SOURCES and OBSERVATIONS: (1) Weighted average of 7 categories reported in J. Szturm de Sztrem (1924) p. 396. (2) Wholesale prices in terms of gold. The first series correspond to official figures for January 1914=100, from Republic of Poland (1927) p. 21. The second series uses a different wholesale price index for deflating exchange rates; from J. P. Young(1925) vol. II p. 349 .

Like in Austria and Hungary the incompatibility between desired real wages and external balance, at least with international capital markets closed, appeared very clear. Foreign credits seemed the natural solution and the Polish authorities repeatedly approached international capital markets for help. But the Polish attitudes in this regard, and also as regards the country's adjustments to the new frontiers, stood in sharp contrast with those of Austria and Hungary. It is significant that the failure of the "sound finance" experiment under Michalski did not lead the government to the immobility of the hopelessness one observes in Austria and Hungary after the resignation of Hegedüs. The Polish government had very clear that deep structural adjustments had to be carried out in order to adequate the new Poland to its new frontiers. This implied the realization of a number of investment projects to which the government also assigned strategic importance; the outstanding examples are the redesigning and unification of Polish railways and the construction of a port alternative to Dantzig (Gdansk)[5].

[5] Dantzig was given by the Peace Treaties the status of a "free-city", though it was established that Dantzig would remain on a customs union with Poland for some undeterminate time. This, in principle, would assure the Poles access to the port , but in practice there were difficulties that led eventually to the construction of a new port in Gdynia just a few miles from Gdansk inside Polish territory.

Indeed, after Michalski's resignation the government sidelined its commitments to austerity and plunged into heavy investment spending notably on the state railways: in 1922 government investment expenditure totaled US$ 25 million representing approximately 20% of total government expenditure; in 1923 this total was raised to US$ 61 million accounting for nearly 33% of government expenditure[6]. From the end of 1921 to the end of 1923 the length of Polish railway network was increased by approximately 8.5% and the number of locomotives in operation rose by nearly 35%[7]. The Poles did not have much alternative as regards the financing of these projects; it is interesting that they went to foreign money markets but to see whether they could interest foreign investors on these projects and not like Austria and Hungary to procure a large stabilization loan[8]. But the contrast with Austria and Hungary was not merely a question of attitude; the investment projects carried out by the Polish government, and also the ones that Austria and Hungary necessitated, had a high import content, so that the binding constraint was not domestic financing - which could always be solved be money creation - but capacity to import. The Austrian and Hungarian positions in this regard were pitiful, and so was Poland's before the annexation of the coal producing and industrial district of Upper Silesia in the middle of 1922. The reintegration of Upper Silesia represented an extraordinary improvement to the Polish international accounts. Monthly exports averaged only US$ 5.1 million in the first semester of 1922, which represented approximately 45% of imports in this period; in the third quarter exports jumped to an average of US$ 12.3 million, which meant 112% of imports and in the fourth quarter it reached US$ 16.5 million or 97.5% of imports[9]. These trade results are even more significant if we consider the fact that with Michalski's resignation and the end of austerity the activity level was greatly increased in the second semester of 1922: the average level of unemployed workers in the first semester was 135 thousand and in the second semester it was reduced to 70 thousand[10].

Poland had been a net importer of coal before Upper Silesia; the levels of

[6] Republic of Poland (1926b) p. 173.
[7] *Ibid* p. 55.
[8] Z. Landau(1974) pp. 286-287.
[9] J. P. Young (1925) vol II p. 354, E. H. Young(1924) p. 53.
[10] E. Wicker(1984) p. 5.

domestic consumption were of around 18.6 million tons yearly and in and in 1921 domestic production had reached only 7.6 million tons. Upper Silesia added 30 .0 million tons of annual production, turning Poland into a net exporter of coal[11]. As regards industrial production Upper Silesia alone could produce nearly three times as much coal and steel, five times as much pig iron, more than four times as much rolled goods, and eight tomes more zinc ore than the rest of Poland[12]. Thanks to this circumstance Poland could maintain a consistently large level of imports[13] which was very helpful for the reconstruction programs being undertaken. It is very significant that the Poles preferred to increase imports than the more "unproductive" piling up of reserves necessary to effect the stabilization.

Polish attitudes towards foreign credits were distinctively different from Austrian and Hungarian ones not only as regard reconstruction and adjustment but especially as far as conditionality was concerned. The experience of 124 years of often repressive foreign domination and the traumas of the war of liberation led to a feeling highly contrary to anything that could loosely resemble foreign interference in domestic affairs. The perspective of seing in Poland something like what was happening in Austria and Hungary seemed, on one hand, to terrorize Polish authorities, though the obvious convenience of foreign credits produced a somewhat more ambivalent attitude. The issue was very much debated within Poland[14], but this did not reflect on Polish diplomacy towards foreign money markets. In a careful account of the Polish efforts to obtain foreign credits a historian observed that "the real interest of the Poles was the gaining of access to foreign financial markets with a minimum blow to their national pride and with the need to take unpopular internal measures reduced to an absolute minimum required to open those foreign markets"[15].

Though little concrete action was taken, the discussion of stabilization was very active during 1923. After the assassination of the first elected president of the Polish republic in December of 1922, a coalition cabinet of pacification was formed and behind

---

[11] A. B. Barber(1923) p. 63.
[12] Z. Landau & J. Tomaszeweski(1985) p. 36.
[13] It is simptomatic that the Polish preferred to increse imports than to pile up reserves in order to prepare for stabilization, certainly a more "productive" investment.
[14] F. Zweig(1944) p. 39.
[15] R. H. Meyer(1970) p.71.

its authority summoned a meeting of all former ministers of finance to discuss the issue. The summit strongly supported the attempt to obtain foreign credits but acknowledged the difficulties in obtaining these credits in favorable conditions before a thorough stabilization attempt had started[16]. While negotiations were taking place in London[17], the Poles, playing by the rituals of international money markets, invited British financial expert Edward Hilton Young, former Under-Secretary of the Treasury in Britain, to report on the Polish financial conditions. But the initiative had little effect on the British which seemed rather considering, as later would become clear, a plan through the League of Nations like the ones for Hungary and Austria[18]. But not only the Poles felt uncomfortable, to say the least, about the conditionality involved in the League scheme but it also feared that the blossoming cooperation between the British and the Germans would result in the British support to Germany regaining its leverage in Central Europe and in particular to German territorial claims over Poland[19].

In sum, the somewhat unorthodox attitudes of the Polish authorities towards reconstruction and the conditionality issue precluded the country's access to international credits. The annexation of Upper Silesia represented a very significant improvement on the country's international position yet it took place immediately after Michalski's failure, or in a moment at which the sentiment was not favorable to the sacrifices involved in another orthodox plan. But as inflation climbed to hyperinflation proportions during 1923, the government had to reconsider the stabilization problem.

9.3) Grabski's Stabilization Plan

In the end of 1923 an extra-parliamentary cabinet headed by Wladislaw Grabski was empowered and in January 11th 1924, it was granted *plein pouvoirs* to conduct a stabilization plan. The failure of the loan negotiations in London led Grabski to "get rid

---

[16] M. A. Heiperin(1931) p.105, L. Czarnozyl(1930) pp. 63-68 and E. Strasburger (1924).
[17] T. Mincer(1927) p.19.
[18] H. Clay(1957) p.258 passim and L. Chandler(1958) p.392 passim .
[19] Z. Landau & J. Tomaszewski(1984) p. 272 and Z. Landau(1974) p.285 passim.

of the Young mission in a diplomatic manner"[20] and to turn his attention to the American capital market; a loan was proposed to J. P. Morgan, but refused in view of of "budget instability"[21].

Grabski went ahead with his plan anyhow, challenging conservative opinion that at this moment was "somewhat aghast" on the issue; The Economist referred to the Polish plan as "a break with consels of caution in financial and monetary policy, and shows us a picture of a young and inexperienced state , without even a tradition of settled monetary conditions and without external help, attempting the difficult problems of financial reconstruction and currency reform concurrently"[22].

Table 9-2
Poland: international reserves, real value of the money supply and cover ratio
(millions of dollars, December 1923 to June 1924)

	Date	Money Supply[1]	Int'l Reserves[2]	Cover Ratio
1923-	December	29.3	9.0	30.7%
1924-	January	36.4	9.8	26.9%
	February	57.7	18.6	32.2%
	March	67.4	23.7	35.2%
	April	65.1	29.8	45.8%
	May	79.3	43.4	54.7%
	June	79.9	65.6	82.3%

SOURCE: J. P. Young(1925) vol. II pp. 348-353.

The government's position in January was not very comfortable, as seen in Table 9-2. In fact it was worse than that; the net reserve was of only US$ 2.5 million. In addition to that, an amount of US$ 4.0 million in hard currency had been deposited with the Treasury as a result of an agreement between the government and industrialists as regards the first installment of the capital levy passed in August of 1923[23]. With these corrections the cover ratio in January would be reduced to approximately 18% which correspond to approximately 6% of the stable-prices money supply[24]. The margin of success was indeed

[20] Z. Landau & J. Tomaszewski(1984) p. 272.
[21] P. Robin(1927) p.19.
[22] *Apud* L. Smith(1936) p.150.
[23] G. Zdziechowski(1925) p. 15.
[24] As measured by the real value of the money supply in the first quarter of 1925, i. e. approximately 110 million dollars.

very narrow, but according to Grabski, "we had to take the plunge, for although US$ 2.5 million is very little indeed ... there was no other way out"[25] . This could certainly be interpreted that the alternative was the League scheme.

The stabilization was successfully effected[26] at a rate described as "correspond[ing] strictly to reality"[27]; as explained in Chapter 5, to stabilize at the market rate required less reserves to be sustained at least during its first moments. The real problem was to obtain reserves to maintain the peg for a prolonged period; this meant to promote some more "permanent" improvement in the country's external position so as to make the wage pressure that would follow the stabilization compatible with external balance. Indeed, as shown in Table 9-3, wages made very substancial gains with the stabilization, actually more than doubling in real terms between December of 1923 and February of 1924; correspondingly, real exchange rates suffered a marked deterioration during the first months of the stabilization. This would be partly compensated by increases in unemployment: the average number of unemployed workers in the last quarter of 1923 was 62 thousand; this was raised to 107, 110 and 157 thousand in the first three quarters of 1924[28]. Even so the trade deficit suffered a continuous deterioration after the stabilization: during 1924 the quarterly trade balances were +11 , -65 , -51 and -107 million zloty, in the first two quarters of 1925 the deficits were raised to -179 and -240 million zloty respectively[29].

[25] *Apud* G. Zdziechowski(1925) p. 15.
[26] And the hyperinflation was immediately stopped consequently. The weekly inflation rates, as expressed for the index of wholesale prices, beginning in the first week of January were 22.3%, 33.6%, 19.7%, 4.2% and -6.0%. As measured by the cost of living in Warsaw , the fortnighly inflation rates, starting in January were of 89.6%, 31.7% and -1.9%. Cf. E. Rose(1924) p. 26.
[27] *Ibid*. p. 19 .
[28] E. Wicker(1984) p. 5.
[29] S. Starzynski (1927) p. 84.

Table 9-3
Poland: real wages and real exchange rates during Grabski's stabilization
(january 1914=100)

	Date	Real Wages[1]	Real Exchange Rates[2]		
1923-	November	56.0	81.1	55.1	83.4
	December	44.0	95.0	79.7	103.7
1924-	January	88.0	106.9	120.5	122.0
	February	103.5	111.8	127.4	125.6
	March	104.0	110.4	126.3	123.4
	April	103.5	109.0	126.5	121.2

SOURCES and OBSERVATIONS: (1) Weighted average of 9 categories reported in ILO (1925) pp.115-116. (2) The first two series are from G. Zdziechowski (1925) p. 7 and correspond to wholesale and consumer prices in terms of gold, for January 1914=100. The third series is a wholesale price index with different coverage but expressed in terms of gold with the same series for exchange rates, from Republic of Poland (1926a) p. 321.

The key to the stabilization should be a "permanent" improvement in the country's payments position that could accommodate this deterioration in the current account. Although this was partly accomplished by the incorporation of Upper Silesia, the Poles seemed to see the reopening of international capital markets as the definitive solution to their problem. During the first semester of 1924 little could be done in this regard except by holding the currency stable by all possible means until the situation appeared settled enough to permit financial support to be obtained outside the League or without stringent conditionality.

The government used three main weapons to pile up reserves during the critical first semester of 1924 : one was the domestic issue of indexed bonds in exchange for hard currency, the second was the domestic subscription of a new bank of issue and the third was the resort to foreign financial help through smaller loans floated outside the main financial centers and the accumulation of short-term commercial credits. On account of the first approximately US$ 5 million were placed during the first three months of 1924[30]. As regards the new bank of issue, in March 31st subscriptions were closed and 99% of the nominal capital of 100 million zloty, or US$ 19.3 million, was subscribed in hard

[30] These indexed bonds included a 5% "premium Dollar loan", indexed to the dollar, the 6% taxation bonds issued in antecipation of revenues, the10% railway loan and the 8% Treasury notes, all indexed to the zloty. The net issues were of 11.2 million zloty in January, 10.1 million in February and 4.7 million in March. Cf. E. Rose(1924) pp. 8-9, 14, Republic of Poland (1926b) pp.166-167 and G. Zdziechowski(1925) p. 19.

currency with negligible foreign participation[31]; this was basically a way to capture private hoards of foreign currency. In March the Polish government contracted a loan of 400 millions lire, or around US$ 17.7 million, with the Banca Commercialle Italiana on the basis of the revenues of the state tabacco monopoly[32]. Though not very large it was certainly significant: the amount was little less than half of the League loan for Hungary. Despite the uncertainties involved, the loan was very successful in Italy being oversubscribed five times[33]; this had a very positive repercussion on the main financial centers[34]. In addition to that the Polish government managed to obtain from the French government a commercial credit of 400 million French francs, the equivalent to US$ 21.0 million, for the purchase of army supplies, from which no more of 1/4 of the total credit was actually drawn[35]. The contribution of all these operations accounts for most of the increase in reserves verified until the opening of the new bank of issue in June shown in Table 9-2 and the overall increase for 1924 shown in Table 9-4.

During the second semester of 1924 reserves remained more or less constant around US$ 70 million despite the continuous worsening of the trade balance. It is interesting to observe that "unaccounted" capital outflows in 1923, which we can safely assume to correspond to "flights from the currency", summed about US$ 45 million. The return of these funds in 1924, which is indeed shown in the balance of payments figures as private short-term capital inflows, have certainly played a part , most likely in the second semester of 1924, in maintaining the stock of reserves stable in this period[36]. The hyperinflation was successfully stopped but more permanent solutions to the Polish payments problem seemed necessary.

---

[31] E. Rose (1924) p. 21.

[32] Only two tranches of the loan would be due in 1924: one of US$ 9.2 million was due in May and the another of US$ 2.7 million was due in November. Cf. Republic of Poland (1926b) pp.166-167.

[33] In this respect it is significant that the loan paid 7% , and was issued at 89, conditions quite unfavorable for Poland yet attractive to investors. Cf. E. Rose (1924) pp. 14-15.

[34] A Polish authority observed that "perhaps the greatest advantage derived from this loan" was that its success "enlightened foreign capital to the possibilities of investment in Poland" and added that the Polish "should remember this with gratitude". Cf. G. Zdziechowski (1925) pp. 21-22.

[35] L. Czarnozyl(1930) p. 77 and M. A. Heilperin(1931) p.134 .

[36] A significant contribution was also made by the indemnity paid by the Russians on account of the Peace of Riga ending the Polish-Soviet war in 1920. The indemnity summed to approximately 8 million dollars.

Table 9-4
Poland: Balance of Payments, 1923-1926
(millions of zloty)

	1923	1924	1925	1926[f]
exports[a]	1167.3	1219.9	1260.2	1259.9
imports	1116.6	1478.6	1602.8	896.2
trade balance[a]	50.7	-258.7	-342.6	363.7
current account	128.1	-215.0	-320.2	377.2
loans				
government[b]	-11.4	68.9	205.8	-36.7
private[c]	84.8	255.2	148.5	69.2
commercial credits	-	43.7	-306.2	95.9
direct investment[d]	31.1	70.7	58.9	17.1
total capital	103.5	438.5	107.0	143.2
change in reservese	-39.8	194.5	-224.2	149.2
unaccounted	-227.0	-2.2	43.0	-366.2

SOURCES and OBSERVATIONS: (a) Includes an adjustment for Dantzig trade. (b) Includes municipal loans of 0.3 million in 1924, 43.9 millions in 1925 and 6.3 millions in 1926. (c) Banks inclusive. Includes 5.0 millions of bills of the Bank of National Economy in 1925. (d) Includes also net sales of securities, net sales of real state and in 1924 includes 42.4 million relative to the Russian Indemnity established by the Riga Treaty. (e) Includes net outflows of bullion. (f) All values computed at the parity of 1923. For 1926 for which the original data is reported at the new parity we converted it at the old parity for the sake of comparison. From LN (1927) pp. 141-151 and (1928) pp. 180-190 and Bank of Poland (1930) pp. 95-96.

9.4) The collapse of 1925

The external accounts were not helped but a liberal tariff policy initiated in the summer of 1924 and a bad grains crop in the fall[37]. It is fair to say that in the end of 1924 there was no more returning capital accruing from previous "flights" from the currency[38], so that at this moment the Poles seemed to face very clearly the second round of their stabilization strategy: the hyperinflation had been stopped by pegging the exchange rate, but the ensuing wage pressure reduced (appreciated) the real exchange rate and now reserves seemed severely pressured. The basic problem of mantaining external balance at the desired level of real wages appeared to become threatening again.

[37] F. Mlynarski (1926) pp. 40-45.
[38] This can be seen, for instance in the sizeable reduction of short-term capital inflows on private account from 1924 to 1925. Cf. LN (1927) pp. 141-151.

The Polish authorities, Grabski in particular, seemed to perceive this to be the time to approach international capital markets again in order to accomplish a more "permanent" solution for their problem[39]; the stabilization was now one year old and reserves were high, so that Poland was in a position to negotiate a solution in favorable terms[40]. Again little help could be found in London, as the British still insisted upon the League alternative. The American capital market was much more receptive; the Poles managed to float a US$ 50 million loan under Dillon, Reid & Co. and most importantly, without any kind of conditionality. The loan resulted to be a failure, however; only half of the original issue could be placed which was attributed to the increased political tensions with Germany which created "a peculiarly disquieting atmosphere"[41] that would escalated in June into a tariff war with serious consequences to Poland's trade[42].

More important than the loss in terms of the proceeds of the loan was the fact that it failed to reintroduce Poland to international capital markets or that it did not trigger the steady influx of foreign capital the Polish expected. The Bank of Poland started to loose reserves in a very fast pace from April of 1925 and despite the help of a number of international banks, including the Federal Reserve Bank of New York[43], the intervention proved hopeless: reserves fell from the high mark of US$ 47.3 million in March to US$ 30.8 million in May, then to US$ 14.2 million in July and to US$ 7.2 million in September, to reach the level of -US$ 3.2 million in November. From August, when the zloty was allowed to float until June of 1926, when it was stabilized again , the zloty lost 42.5% of its value.

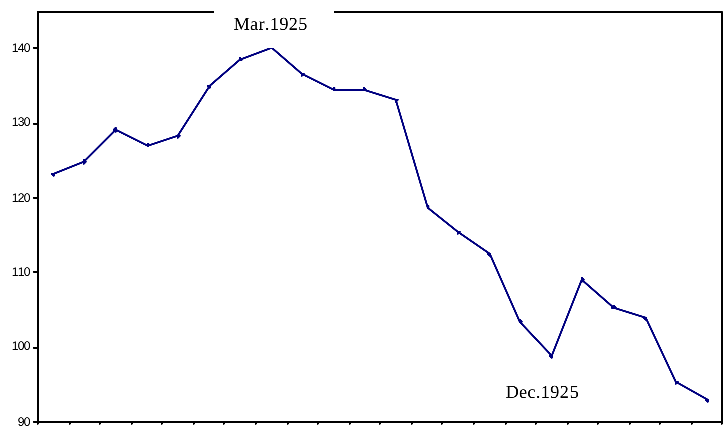
The collapse of 1925 did not represent the return of the hyperinflation and in this sense it cannot be said to be a failure of the Grabski Plan; in fact the episode seemed like a post-1945 type devaluation under the Bretton Woods system. One possible explanation for that is related to the fact that many sliding scales clauses and indexation schemes had

---

[39] M. A. Heilperin (1931) p. 134 .
[40] Z. Landau & J. Tomaszewski(1984) p.279 and Z. Landau(1974) p. 289.
[41] F. Mlynarski(1926) p. 48 .
[42] C. Kruszewski(1943). This "war" consisted on sucessive import prohibitions and retaliatory moves from each side which affected 47% of German exports to Poland and 57% of Polish export to Germany. Poland was in a flagrant disadvantage, as the Polish prohibitions affected what corresponded only to 3% of the total exports of Germany while the German embargo affected 27% of total Polish exports. Cf. Z. Landau & J. Tomaszewski(1984) p. 281. Overall, however, the Polish managed to redirect her exports so as to avoid any sizeable fall in total exports. Cf. S. Starzynski (1927) pp. 84-85.
[43] Z. Landau & J. Tomaszewski (1984) pp.282-283 and R. H. Meyer(1979) pp. 63-64.

already been dropped from labor contracts at this point. Wages suffered a blow with the depreciation and this tighter fiscal and monetary policies produced very significant increases in unemployment. The wage restraint thus provoked limited the inflationary impact of the depreciation and produced consequently an improvement in competitiveness shown in Chart 9-1. This combined with the implementation of a very restrictive commercial policy produced a contraction of 44% in imports from 1925 to 1926[44]. This sharp improvement in the current account could accommodate a sizeable "flight" from currency and even produce a significant increase in reserves as shown in Table 9-4.

Chart 10-1
Poland: real exchange rates, August 1924-May 1926



SOURCE: Wholesale prices in terms of gold from Republic of Poland (1927) p. 322.

Once more the Poles went to international capital markets for help; this time they approached Benjamin Strong, who had helped them in the attempt to prevent the depreciation of the zloty in 1925, and found a sympathetic ear for their endeavors to avoid the League alternative, at this point strongly insisted upon by the British[45]. At the same time, following advice from Dillon, Reid & Co. the Poles once more invited a

---

[44] It should be mentioned that the tariff war against Germany helped the effort to curtail imports to the extent that imports from Germany were specially hit by the new Polish tariffs. Total imports from Germany reached 506 million zloty in 1924, representing 32.2% of Polish imports , and in 1926 they represented only 26.6% of total imports having fallen to 211 million zloty. Cf. S. Starzynski(1927) p. 92.

foreign financial expert to report on Polish finances, this time the celebrated American professor Edwin W. Kemmerer from Princeton University, widely known as mentor of a number of currency reforms around the world, especially in Latin America[46]. Kemmerer reported on January 1926, but as it happened with other experts' reports on Poland , it had no apparent effect on policy.

In May 1926 a *coup d'état* would bring to power charismatic leader marshal Pilsudski, but this would represent no discontinuity with respect to past economic policies, on the contrary, the new regime seemed still more determined in establishing a steady influx of foreign capital into Poland[47]. Pilsudski maintained a second invitation to Kemmerer, but the loan negotiations in New York again found a serious obstacle on the issue of "control" or conditionality[48]. But finally the Polish negotiators managed to explore the diversity of interests and mutual commitments of central bankers and the consequent difficulties of coordination of an international action in such a manner that they were able to sign a loan agreement in October of 1927 with very little and vague conditionality[49]. The agreement included a loan of US$ 62.0 million and £2.0 millions and also an emergency credit facility of US$ 20 million to be used in moments of pressure over the zloty[50]. After that, the stability of the zloty was not to be disturbed even by the 1931 crisis.

9.5) Summary and conclusions

Polish attitudes towards stabilization contrasted sharply with those of Austria and Hungary as regards both the priority given to investment expenditure and tolerance to stringent conditionality. It is difficult to judge whether or not the Poles did better than

---

[45] R. H. Meyer(1970)pp. 69-73, L. Chandler (1958) p. 392 and H. Clay (1957) p. 259.
[46] R. N. Seidel(1972) and P. W. Drake (1979).
[47] Z. Landau(1977) p.180 and (1981) p. 177.
[48] The Polish had extensive negociations with Bankers' Trust & Co. by with no practical result, according to Benjamin Strong "it having been found impossible by the Polish Government to agree to certain forms of financial control which the Banker's Trust Company desired to impose as a condition to the granting of such a loan ". Apud R. H. Meyer(1970) p. 68.
[49] The loan agreement indeed prescribed a resident financial "advisor" and a system of periodical reports, though the advisor had actually very little power in influencing policy within Poland and no powers regarding the proceeds of the loan . For details see R. H. Meyer(1970), L. Chandler (1958) and H. Clay (1957).

otherwise mostly because it is difficult to conceive the conterfactual scenario. It is true, for instance, that a second Michalski type stabilization attempt late in 1922, thus after the reincorporation of Upper Silesia, would imply in postponing most of the investment projects undertaken during this period; depending on how foreign finance reacted to that, these projects could remain on hold for a considerable period of time. On the other hand an earlier, and a more well behaved, stabilization would allow the Poles to enjoy more of the abundance of foreign capital observed during the second half of the 1920s. Foreign money markets seem to have gained confidence on the Poland as far as foreign direct investment was concerned only after the floating of the large stabilization loan late in 1927, thus almost at the end of the capital exports bonanza of the 1920s. Inflows of capital into Poland during 1927-1928 represented 30.1% of this period's total exports; for Hungary, which is the appropriate country for comparison, capital inflows reached 63.1% of exports in this same period[51]. In sum, there were rewards and penalties for "good behavior" and by no means the balance is clear for Poland.

The "unaided" stabilization of 1924 used instruments to obtain hard currency that Austria and Hungary also used, like the floatation of indexed bonds domestically and the subscription of a new bank of issue. Two basic differences emerge; one was the financial help obtained from "secondary" financial centers and the other was the annexation of Upper Silesia. The French and the Italians did not have a smooth relationship with the British and the Americans during the 1920s as far as financial issues were concerned. The accounts are several on rivalries and disputes around areas of influence especially as regards spots left open by Germany[52]. The Poles perceived these intricacies and managed to use them to obtain moderate, though very important, help from Italy and France and to win the Americans to their cruzade against the British alternative through the League. No initiative of this sort is to be found in Austria and Hungary.

But the most important "aid" to the stabilization came from Upper Silesia, whose annexation represented a "permanent" improvement in the country's external position that partly solved the incompatibility between the demands of the labor movement and the requirements of external balance. Thanks to Upper Silesia Grabski could sustain the

---

[50] Details in J. F. Dulles(ed.)(1928).
[51] See Table 2-1. On capital movements into Poland see L. Wellisz(1938).

stabilization without much help from abroad, with a small stock of reserves and with expansionary, or at least non-contractionary, financial policies. Yet, Upper Silesia was not enough to accommodate the sharp increase in real wages, and the implied deterioration in competitiveness, that followed the stabilization. By stabilizing the exchanges at the market rate Grabski was establishing a level for real exchange rates that was too high at zero inflation, as discussed in Chapter 5. Inflation was a way to maintain wages below their targets, so that without inflation wages should quickly reach their desired levels. This happened during Michalski's plan and happened again with Grabski. In the former's case the already high trade deficit increased sharply and quickly, and reserves were soon depleted. For the latter, there was a trade surplus at the onset of the plan, the deficit took a few months to reach a sizeable magnitude and they counted on the foreign credits, the indexed bonds and on the subscription of the new bank to resist the pressure during the first semester of 1924. Returning funds, the Russian indemnity and commercial credits helped to hold the line after June, but unless some "permanent" solution was provided the collapse was inevitable.

In fact the floating of the zloty in 1925 was not strictu sensu a collapse, it was the second round of the stabilization problem, the one of achieving external balance at wages closer to their targets. This time unemployment was sharply increased and such self-inflicted sacrifices finally opened the door of international capital markets to Poland. Most likely, however, it was too little and too late.

---

[52] See for example D. Silverman (1982) F. Costigliola (1977).