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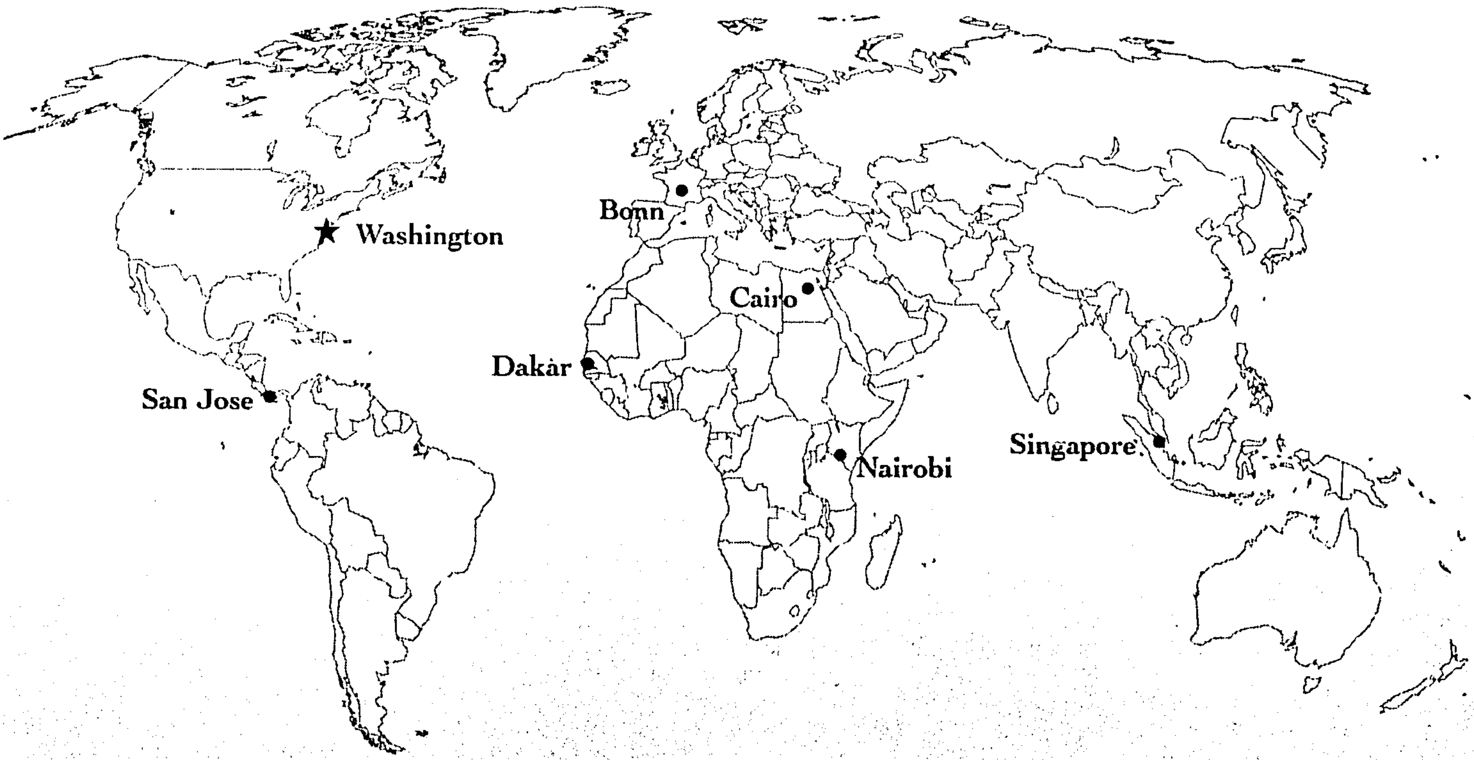
Regional Inspector General for Audit
Bonn

Audit of the U.S. Government's Contribution to the Polish Bank Privatization Fund

Report No. 8-181-94-016
September 23, 1994



INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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September 23, 1994

MEMORANDUM

TO: DAA/ENI, Barbara Turner

FROM: D/RIG/A/B, Fred Kalhammer Kalhammer

SUBJECT: Audit of the U.S. Government's Contribution to the Polish Bank Privatization Fund (Audit Report No. 8-181-94-016)

This is our final report on the subject audit. In preparing the report we carefully considered your comments and those provided by the Department of the Treasury and included them as Appendices II and III, respectively.

This report contains one recommendation to the effect that the ENI Bureau and the Department of the Treasury consult with the Polish Government on the future use of interest earned on the USG contribution to the Polish Bank Privatization Fund so as to encourage the Polish Government to use such interest earnings for the same purposes as the Bank Fund. Please provide us information within 30 days on actions taken to implement the recommendation and, if the Polish Government agrees to use some or all of the interest earnings for the same purposes as the Bank Fund, the amount of such interest earnings.

I appreciate the cooperation and courtesies extended to my staff during the audit.

Introduction

After the fall of Communism, the Polish Government began the process of transforming its centrally-planned economy to one driven by market forces. A key step in the process was creating an efficient banking system capable of operating under free-market conditions. Hence, the Government began a program to modernize and privatize Poland's nine state-owned commercial banks, privatizing two. However, efforts to privatize the other seven banks have been thwarted primarily by the large portfolios of problem loans held by the banks.

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To assist the Government in preparing the seven banks remaining under state ownership for privatization, the Bank Privatization Fund—made up of contributions by seven countries, with the U.S. Government contribution being the largest—was established in December 1992. The Polish Government has issued government bonds to the seven banks to capitalize them against the problem loans. After the banks are privatized, the Bank Fund will be used to help pay interest and/or principal to holders of the government bonds.

As of March 31, 1994 seven countries had contributed a total of approximately $425 million to the Polish Bank Privatization Fund. The table below shows the amount and type of each country's contribution.

CONTRIBUTIONS TO THE POLISH BANK PRIVATIZATION FUND AS OF MARCH 31, 1994

Contributing Country	Type of Contribution	Amount[1] (000's)
United States	Grant	$199,140
Japan	Loan	146,421
United Kingdom	Grant	75,000
Sweden	Grant	3,239
Australia	Grant	1,000
Finland	Grant	518
Iceland	Grant	18
Total		**$425,336**

[1] *Interest earnings on the contributions not shown.*

Audit Objectives

The audit is designed to answer the following questions:

- **How did the U.S. Government's contribution to the Polish Bank Privatization Fund come about, and what is its current status?**

- **How are contributions to the Polish Bank Privatization Fund managed?**

Audit Findings

How did the U.S. Government's contribution to the Polish Bank Privatization Fund come about, and what is its current status?

The U.S. Government's (USG) contribution to the Polish Bank Privatization Fund—approximately $199 million—consists of funds originally destined to help establish the Polish Stabilization Fund. That Fund, created in December 1989, included contributions by the USG and 17 other countries, and was intended to help stabilize the Polish currency, but was never used. In January 1993, the Stabilization Fund was dissolved by mutual agreement among the Polish Government and the Fund contributors, and the USG's and several other countries' contributions were transferred to a new fund, the Bank Privatization Fund (Bank Fund), established to help privatize seven banks. As of March 31, 1994 the Bank Fund, including the USG contribution, had not been used. However, the Polish Government had used approximately $10.3 million of accrued interest earnings on the USG's contribution to the two funds to pay interest on other Stabilization Fund contributors' loans, as well as fees to law and accounting firms.

<u>Stabilization Fund a Success Although Not Drawn Upon</u>

In the late 1980s, after more than forty years of central planning, Poland's economy was in severe crisis: prices were rising at an accelerating rate—from 8.5 percent per month during the first half of 1989 to more than 30 percent per month in the second half; the budget deficit was increasing very rapidly; shortages of goods, raw materials, and energy were occurring; and manufacturing output was dropping significantly. The U.S. Congress recognized that Poland's economy was struggling and included in the Support for East European Democracy Act of 1989, the authorizing legislation for the U.S. assistance program to central and eastern Europe, a provision directing the President to grant assistance to Poland to help stabilize the Polish economy and promote long-term economic growth and stability. Congress authorized $200 million in grant funding for this purpose.

The Polish Stabilization Fund was established in December 1989 and received contributions from 18 contributing countries, including the USG. The purpose of the Fund was to provide a reserve of internationally convertible currencies to help stabilize the value of Poland's currency and support its convertibility. The USG contribution was made with funds appropriated to USAID, and then transferred to the Department of the Treasury under an interagency agreement.[2]

In comparison to other contributing countries, the USG contribution was by far the single largest cash contribution. According to Treasury officials, the USG encouraged other countries to the follow the USG lead in providing cash grants. However, several did not:

- seven contributing countries made loans requiring repayment by the Polish Government, some interest-bearing;

- two countries established lines of credit for use by the Polish Government; and

- two countries that contributed cash imposed certain conditions on the use of their donations, such as requiring the Polish Government to repay the cash donation should the funds not be used as intended.

The Stabilization Fund, although never used, was considered a success by Treasury officials insofar as it provided the psychological confidence needed to stabilize and support the convertibility of Poland's currency, for which reason the Poiish Government never found it necessary to draw on the Fund. As evidence, these officials point to the fact that Poland currently has the fastest growing economy in Europe and that exchange stabilization was critical to this progress.

The ENI Bureau stated that it is not correct to consider the Stabilization Fund as not having been used during this time, just because the Fund was not actually drawn on and expended to support the Polish currency, the *zloty*. According to the Bureau, U.S. grant funds were used to support the *zloty* at its new parity without having to be drawn upon,

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[2]A large portion of funding appropriated to USAID for the Central and Eastern European program has been transferred to other U.S. Government agencies. As of December 31, 1993 USAID had transferred approximately $465 million to 19 other agencies, including $199.1 million to the Department of the Treasury for the Polish Stabilization Fund.

noting that the funds became available to be used again, this time to assist in the privatization of state-owned banks—a true case of 'two bangs for a buck.'

The Bureau further stated that the success of the Polish economy in becoming the fastest growing economy in Eastern Europe was due to two factors: (1) an economic stabilization program whose seriousness merited the creation of, and the risks involved in, a currency stabilization fund, and (2) the stabilization fund itself.

The Stabilization Fund was terminated in January 1994 by agreement among the Polish Government and the contributors to the Fund, and a new fund was established to bolster efforts to restructure Poland's banking system.

Bank Privatization Fund Established

Part of the Polish Government's efforts to move to a market-driven economy included modernizing and privatizing its banking system. In 1989 the Government established a two-tier system consisting of the National Bank of Poland (NBP) and nine regional banks. Commercial lending, which had previously been the responsibility of NBP, was assigned to the regional banks, while NBP began functioning as a central bank.

In 1991 the Government transformed the nine regional banks into stock companies wholly owned by the Government. Later that same year Poland's Ministry of Finance selected the two strongest regional banks for privatization and, in 1993, privatized them by selling about 70 percent of the stock in each—about 30 percent to foreign banks, 20 percent to bank employees, and 20 percent to the public through the Warsaw Stock Exchange. The Government retained about 30 percent of the stock in each bank.

The Government also wanted to privatize the remaining seven regional banks, but its intent was impeded by the large number of problem loans to state-owned enterprises within the banks' portfolios. Most of these loans were made in a period of hyperinflation (1990-91) during which state-owned enterprises, reacting to the super-heated economy, increased borrowing to a point at which they could no longer service their debts. Nevertheless, the state-owned banks continued to make them loans, giving little consideration to risk or the financial status of borrowers. In some cases, the banks rolled over debt and capitalized unpaid interest. As a result, by mid-1991 problem loans comprised about 40 percent of total loan portfolios, according to the World Bank.

To assist in privatizing the remaining seven state-owned regional banks, the Polish Government, with the assistance of some of the donors who contributed to the Stabilization Fund, established the Bank Privatization Fund in December 1992. The Polish Government has issued government bonds to the seven banks to capitalize the banks' problem loans and, until the banks are privatized, will pay interest on the bonds. As each bank is privatized, the Bank Fund will then be used to help pay the interest and principal on the bonds.

With USAID, Treasury, and Polish Government agreement, the USG contribution to the Stabilization Fund, approximately $199 million, was transferred to the new Bank Fund. Although the USG encouraged other contributors to the Stabilization Fund to follow the USG lead, only six other countries made contributions to the new fund—including two who contributed only the interest earnings that had accrued on their contributions to the Stabilization Fund. The number of contributing countries declined from 18 to the Stabilization Fund, to seven to the Bank Fund; total contributions declined from over $1 billion to approximately $425 million.

Current Status of the USG Contribution

The USG contribution to the Stabilization Fund, which was later transferred to the Bank Privatization Fund, was deposited by the Government of Poland in an interest-bearing account at the Federal Reserve Bank of New York (FRB/NY) and invested in short-term USG securities. As of March 31, 1994 interest earnings on the USG contribution totaled approximately $34.5 million—approximately $27 million on the contribution to the Stabilization Fund and approximately $7.5 million that accrued after the contribution was transferred to the Bank Privatization Fund. At the time of our field work in April 1994, we were advised by an NBP official that $27 million had been deposited in an interest-bearing Polish Government account at the NBP. The $7.5 million was in a separate interest-bearing account at the FRB/NY. Treasury officials subsequently provided information, discussed below, showing that the Polish Government had used approximately $10.3 million in interest earnings.

At the time of our field visit to Poland in April 1994, none of the seven targeted banks had been privatized and the Polish Bank Privatization Fund—including the U.S. contribution of approximately $199 million—had not been used. According to the Director of the Banking Department at Poland's Ministry of Finance, one of the targeted banks will be privatized by the end of 1994 and the others by the end of 1996. Privatization, according to an advisor to the Ministry, could be achieved through several methods, including merging the target banks with other state-owned or private banks, or selling stock to the general public through the Warsaw Stock Exchange or directly to Western banks. Poland's new Finance Minister, then about to be appointed, was to select the privatization method to be used.

There were no restrictions on the Polish Government's use of the accrued interest earnings on the USG contribution which amounted to $34.5 million as of March 31, 1994. According to Polish Government officials we interviewed during our field visit, those earnings had not been used. The Ministry of Finance was preparing a proposal to use a large portion of the interest earnings in support of a program to guarantee Polish exports to the former Soviet Union. Poland's parliament had recently passed legislation authorizing the export guaranty program. However, Treasury officials subsequently provided us information showing that the Polish Government had used approximately $10.3 million of the interest earnings through August 26, 1994 to pay interest on other

Polish Stabilization Fund contributors' loans, as well as fees to law and accounting firms (see Department of the Treasury comments included as appendix III to this report).

How are contributions to the Polish Bank Privatization Fund managed?

The management structure of the Polish Bank Privatization Fund (Bank Fund) was established by a Memorandum of Understanding (MoU), prepared in December 1992, which established the Fund. Under the provisions of the MoU, the Fund is administered by an Operating Committee composed of representatives from each contributing country. The USG representative, acting through the U.S. Department of the Treasury, is the secretary of the Fund. Voting rights of the representatives are weighted in accordance with the size each donor's contribution to the Fund. Since the USG is by far the largest contributor, its vote carries the greatest weight.

The Operating Committee's primary responsibility is to determine when the Polish Government has met the many conditions established for the Fund's use, as specified in the MoU. The most significant of these conditions require that the Polish Government will have:

- completed audits of the state-owned regional banks and four other specialized banks not covered by the Bank Privatization Fund;
- prepared a timetable for privatizing Poland's banking system;
- achieved the macroeconomic reform targets specified by the International Monetary Fund;
- met the conditions specified by the World Bank for its $450 million Enterprise and Financial Structure Adjustment Loan, whose purpose is to assist in privatizing Poland's state-owned enterprises by reducing their outstanding debt; and,
- privatized at least one of the seven remaining regional banks receiving recapitalization bonds by selling more than 50 percent of stock in the bank.

Communications between the Operating Committee and the FRB/NY, including authorization for the Polish Government to draw on the Fund, are made by Treasury through its telecommunication facilities.

The MoU states that the Bank Fund will expire on January 20, 2003. However, according to the MoU, the Fund would terminate earlier, on January 20, 1995, if no drawdowns have been made by that date, unless agreement to an extension has been reached among the contributing countries and the Government of Poland. Upon termination, remaining contributions and interest earnings will be handled in accordance with instructions from the contributing countries.

As noted earlier, contributions to the Bank Fund are deposited in an interest-bearing account at the FRB/NY. FRB/NY invests the contributions in short-term U.S. Government securities. Earnings from the investments are deposited in a separate earnings account and credited to the contributors based on the size of their contributions to the Bank Fund.

Each contributing country to the Bank Fund ratified provisions of the MoU through a separate bilateral agreement with the Polish Government. In addition, countries who made cash contributions specified how the interest earnings on their contributions should be managed. One required that the interest be used to purchase the donor country's export commodities. The other country required that the Polish Government negotiate use of the interest. The USG's bilateral contribution agreement authorizes the Polish Government to use the interest earnings on the USG cash contribution as the Polish Government sees fit.

Adequacy of the Bank Fund for Program Purposes

It was never intended that the Bank Fund pay the total costs associated with the government bonds issued to capitalize the problem loans of the seven regional banks. Instead, the Fund was to supplement Polish Government payments. Discussions with USG officials in Poland revealed, however, that significantly more contributions may be needed to assist the Government in realizing its goal of privatizing the seven banks. For example, American Embassy officials we contacted were under the impression that Bank Fund contributions totaled $600 million and were surprised to learn that actual contributions totaled only approximately $425 million. They were not aware that contributions pledged by two donors had not been made, and were concerned that the size of Bank Fund may not be adequate to privatize the seven banks.

Treasury officials, however, discounted the comments made to us by American Embassy officials and indicated these officials appeared to have misunderstood the purpose of the Bank Fund. According to Treasury officials, the Bank Fund was not intended to pay the entire principal and interest on the new bonds associated with bank privatization, but to "jump start"/strengthen the bank privatization process by indicating foreign support for the process and offering prospective investors a dedicated repayment source, thereby decreasing the risk of nonpayment.

The ENI Bureau stated that while it is possible that the Bank Fund may be inadequate to assist in privatizing the banks, it questioned whether the difference between the $600 million that was hoped for and the $425 million now in the Fund was so large that the size of the Fund may not suffice to assist in privatizing the seven banks. The Bureau further stated that even if the difference were significant, there is still a very substantial financial incentive for the Polish Government to privatize the banks because it is committed to paying interest and principal on the bonds it has issued to the banks.

We acknowledge that the adequacy of the Bank Fund to assist the Polish Government in privatizing the seven banks is open to question, nor could we come to a firm conclusion on this issue. However, one source of additional assistance to the Bank Fund could be unused past interest and any future earnings on the USG contribution. Although owned by the Polish Government and to be used for its own purposes, from the American taxpayer's viewpoint, interest earnings on the over $199 million made available to Poland five years ago would be better used to further the purposes of the USG donation than to pay interest to other contributing countries or to defray the costs of professional fees incurred by the Polish Government. Accordingly, we are making the following recommendation.

> <u>Recommendation No. 1</u>: **We recommend that the Bureau for Europe and the New Independent States, in coordination with the Department of the Treasury, consult with the Polish Government on the future use of interest earned on the U.S. Government contribution, and urge that it be used for the same purposes as the corpus of the U.S. Government contribution to the Polish Bank Privatization Fund.**

Management Comments and Our Evaluation

The ENI Bureau and the Department of the Treasury generally agreed with our audit findings, although both provided a number of clarifying comments which we have incorporated into the body of the report, as appropriate. The ENI Bureau and the Department of the Treasury comments are included in their entirety as Appendices II and III, respectively, to this report.

Based on the comments provided, Recommendation No. 1 is considered resolved and can be closed when evidence is provided that the Polish Government has been consulted concerning the future use of interest earned on the USG contribution.

SCOPE AND METHODOLOGY

We audited the U.S. Government's (USG) contribution to the Polish Bank Privatization Fund made by the U.S. Department of the Treasury with funds transferred from the U.S. Agency for International Development (USAID). The audit was conducted in accordance with generally accepted government auditing standards. We performed the audit work from February 2, 1994 to August 4, 1994. The audit covered the USG contribution of approximately $199 million and interest earnings of approximately $34.5 million on the USG contribution.

We conducted the audit to determine: (1) the history and current status of the USG contribution to the Polish Bank Privatization Fund, and (2) how contributions to the Fund are managed. We reviewed documentation and interviewed officials in Washington, D.C. at USAID's Bureau for Europe and the New Independent States and the U.S. Department of the Treasury, and in Poland at the Office of the USAID Representative in Poland, the Polish Ministry of Finance, and the National Bank of Poland. We also contacted representatives of the U.S. Embassy and the embassies of other donors to the Bank Privatization Fund in Poland to determine how the USG's and the other donors' contributions are managed.

USAID

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

SEP 21 1994

MEMORANDUM

TO: RIG/A/BONN, John Competello

FROM: DAA/ENI, Barbara Turner

SUBJECT: Draft Report on the Audit of the U.S. Contribution to the Polish Bank Privatization Fund (PBPF)

We have reviewed the subject draft report, dated August 19, 1994, and the report's recommendations are the following:

Recommendation No.1: We recommend that the Bureau for Europe and the New Independent States, in coordination with the Department of the Treasury:

(1.a) consult with the Polish Government regarding the adequacy of the Polish Privatization Fund, and

(1.b) if deemed appropriate, request that the Polish Government consider using the interest earnings on the USG contribution, amounting to 34.5 million as of March 31, 1994, for the same purposes as the Bank Privatization Fund.

We are assuming that the purpose of the consultation would be to try to determine whether or not funds were adequate, and then, depending on the results of that consultation, recommendation 1.b would be followed if and only if it became obvious that additional funding would be required.

The draft report says that the two strongest regional banks, which presumably did not need to be endowed with Polish treasury bonds, were privatized in 1993. USAID/Warsaw advises that it is anticipated that a third bank, Bank Prezenyslowo Handlowy (BPH) will be privatized in mid-January.

Is it possible that funds in the Bank Fund will be inadequate to assist in privatizing the banks? Is the difference between the $600 million that was hoped for and $425 million the Fund now fas so large, that the size of the Fund may not suffice to assist in privatizing the seven banks?

Even if this was true, there is still a very substantial financial incentive for the Polish Government to privatize the banks because it is committed to paying interest and principal on the bonds it has issued to the banks.

Suggestions on form and content:

The authors may wish to use the term "contributing countries," rather than the term "donors," in referring to contributing countries other than the U.S. and the two other countries which also made contributions in the form of grants. With respect to most of the other countries, we are talking about contributors and contributions - not about donors and grants - since not all contributions were in the form of grants and therefore not all the contributors would be considered donors except in a very broad sense, to the extent that their loans contained a "grant element" (e.g. a below-market rate of interest). For example, on page 4 of the report, instead of "several donors made loans," it would seem more accurate to say "several contributing countries made loans." Instead of "two donors who contributed cash" it would seem more to the point to say "two contributing countries which made contributions in the form of grants."

The report begins its discussion of the stabilization fund with the header "Stabilization Fund a Success but Not Used." More accurately phrased, the heading would read "Stabilization Fund a Success Although Not Drawn Upon." To the extent it was a success -and it was - it was because by its very existence it deterred de-stabilizing speculation against the zloty.

The report treats the use of U.S. grant funds for the zloty stabilization fund as a 'non-use' because the funds were not expended at any point to defend the zloty against a speculative attack. It is not correct to consider the funds as not having been used during this time, just because they weren't actually drawn on and expended to defend the zloty. The U.S. grant funds were used to defend the zloty at its new parity without having to be drawn upon. Because the funds didn't have to be drawn upon, they therefore became available to be used again, this time to assist in the privatization of state-owned banks - a true case of two bangs for a buck.

Therefore, it can be argued that in order to minimize the risk that de-stabilizing speculation might take advantage of temporary balance of payments weakness, or of rumors, to de-stabilize the zloty, and that the stabilization program might unravel as a result, it follows that temporary immobilization of funds from U.S. and other contributors in a currency stabilization fund was a good idea, and helped to stabilize the zloty during a difficult period.

Once the danger of such a speculative attack was past, and the Polish Central Bank had been able to build up substantial foreign exchange reserves of its own, it would make sense to do something else with the funds, something else that would also be in support of Poland's program of reform and stabilization.

In fact, once an initial three months had passed, the Polish authorities let the currency's exchange rate move relative to the dollar, and were concerned only to limit the rapidity of this movement. The continued availability of the PBFP from 1990 through January 1994 can be argued to have been a moderating factor in the rate at which the zloty depreciated over this period.

It appears that over the course of 1990 the Central Bank managed to build up its reserves from $2.3 billion (the end-of-1989 level) to $4.5 billion by the end of 1990. After this, the system's international reserves were drained by about half a billion dollars. (Some of these additions to reserves came from drawings on the IMF: Poland increased its borrowings from the IMF by $358 million in 1990 and by another $99 million in 1991, began to pay back in installments starting in the second quarter of 1993, and increased its borrowings again in March 1994, with a stand-by arrangement drawing that increased its outstanding borrowings from the Fund to $810 million).

Presumably the stabilization fund resources were counted as foreign reserves of the Polish Central Bank from the time they were placed in the stabilization fund (December 1989? January 1990?) up to the point in January 1994 when the stabilization fund was terminated. At this point, about 3/5 of these funds reverted to the contributing countries and about 2/5 went into the PBPF. Presumably the PBPF funds, since they are being held in what amounts to an escrow account with the Federal Reserve system, and cannot be drawn on unless and until at least one of the relevant banks are privatized, do NOT count as foreign reserves assets of the Bank of Poland.

In 1989, reserves:imports ratio was 2.3 billion / 14 b (transactions in all currencies) 2.3 / 10.3 in convertible currencies -- in 1990 4.5 / 15; 4.5 / 16.8 ; in 1992, 4.1 / 15.6; In 1990 and in 1994 official debt to Paris Club debtors was rescheduled and in part reduced. BOTTOM LINE: The balance of payments situation clearly eased considerably between 1990 and 1994, allowing the stabilization fund to be terminated and funds to be reprogrammed.

In any event, the purpose of the stabilization fund was clearly met. It helped to stabilize the value of the zloty and to make it convertible.

The draft report, as written, suggests that Treasury believes that it was the existence of the Stabilization Fund alone which enabled the zloty to be stabilized at the target value/in the target range, thereby enabling the Polish economy to recover, and become (currently) the fastest growing economy in Eastern Europe. The draft report should recognize, as it does not now, that success was due to two factors: (1) an economic stabilization program that was good enough to put together and risk a currency stabilization fund for and (2) the stabilization fund itself. The contributing countries made a judgment that a good stabilization program had been put in place and they backed up this conviction with a fund.

The currency stabilization fund was an important factor enabling the Polish reform program to get off the ground successfully. It facilitated a large appreciation in the real exchange rate (from an initially undervalued level) and a big and much needed expansion of imports invoiced in convertible currencies from $9 billion in 1990 to over $14 billion in 1991, which made the initial months less difficult than they otherwise have been.

Turning to the U.S. contribution to the PBPF, the purpose of the PBPF, and that of the U.S. contribution to the PBPF, was to assist Poland in privatizing those large state-owned deposit money banks which at the time of the PBPF's establishment (1) not been privatized and (2) had to be recapitalized by the Polish Treasury's issuance, to them, of interest-bearing, non-transferable Polish Treasury Bonds. The contributing countries would release to the Polish government on a grant or loan basis, the funds they had placed in the PBPF, to the extent it privatized the banks on a timely basis. This would provide the government with resources with which to service and pay off the principal amounts of the bonds it had issued to the banks. If the Polish government failed to privatize the banks, it would pay for the recapitalization of the banks entirely out of its own resources without being able to access the funds in the PBPF.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

SEP 06 1994

Mr. Fred Kalhammer
Deputy Regional Inspector General/
Audit/Bonn
U.S. Agency for International Development
320 21st Street, N.W.
Washington, D.C. 20523

Dear Mr. Kalhammer:

Thank you for the opportunity to comment on the August draft of the "Audit of the U.S. Government's Contribution to the Polish Bank Privatization Fund" (the "Audit"). The Audit is a definite improvement (especially in tone) over the earlier draft which Treasury and AID discussed, and on which Treasury offered comments.

Nevertheless, Treasury does recommend some important changes to the Audit.

(1) DESCRIPTION OF THE POLISH STABILIZATION FUND Polish macroeconomic reforms were the major factor responsible for the stable zloty in the early 90's. Therefore, to make sure that the lion's share of praise is not directed toward the PSF, the word "smashing" should be deleted before "success" on the first line of the second full paragraph on page 4, and the first and second sentences of that paragraph should be joined by deleting the period at the end of the first sentence and "The Fund" at the beginning of the second sentence, and inserting in their place a comma and "insofar as it".

(2) USE OF THE INTEREST The Polish Government has used interest earnings on the U.S. contribution to the Polish Stabilization Fund. Attached is a report prepared by the National Bank of Poland which shows that interest on the U.S. contribution was used to pay interest on other PSF contributors' loans, as well as fees to law and accounting firms.

Accordingly, the last sentence of the first paragraph on page 3 should be deleted in its entirety, and both the third sentence in the bottom paragraph on page 8 and the entire last paragraph on page 6 will have to be redrafted to reflect that approximately $10.3 million of such interest earnings have been spent already.

(3) ADEQUACY OF THE POLISH BANK PRIVATIZATION FUND The American Embassy officials, whose comments are noted in the penultimate paragraph on page 8, appear to have misunderstood the purpose of the PBPF. The purpose of the PBPF was not to pay the entire principal and interest on the new bonds, but to "jump start"/strengthen the bank privatization process by indicating foreign support for the process and offering prospective

investors a dedicated repayment source (albeit partial), and thereby a decreased risk of nonpayment.

Therefore, while the first sentence of the penultimate paragraph on page 8 is correct, the rest of that paragraph should be deleted. It is irrelevant what the US Embassy personnel thought or think about the adequacy of the Fund, and it is inaccurate to say that "Treasury officials" are "concerned" that the PBPF will be inadequate to privatize the seven banks.

Because "adequacy" of the Fund is not an issue, insert in place of the current "Recommendation No. 1" on page 9 the following statement:

> Recommendation: We recommend that Treasury consult with the Polish Government on the future use of interest earned on the U.S. contribution.

Thank you again for this opportunity to provide comments. Please do not hesitate to call me at (202) 622-2130 if you have any further questions. I look forward to reviewing another draft of this report.

Sincerely,

Stephen Canner
Director, Office of
Eastern European Nations

Attachment

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