

Financing the building industry in Poland

By Irena Herbst

THE organisational scheme for the Polish building industry was a coherent part of the whole economy. Its aims and the way it worked were adapted to the aims and the ways of the functioning of the State. The main goal was industrialisation.

During the period of industrialisation the function of the flat was reduced to the function of a place for "reproduction", for the biological recovery of manpower. The organisational scheme of the building industry had been adapted to fulfil just such a function. The housing utilities had been built mainly in the regions where industry had been located — that is in towns or in their environs. Housing was an element of the costs of industrialisation and thus expenses were to be borne by the main founder — the State. It had been decreed that in socialism the aim of all economic activity — including the building activity — was to produce material goods, not to bring profits. The volume of production and not the difference between income and cost had to be maximised.

The flat ceased to be a consumer good bought according to people's needs and resources. The flat gained the attributes of the means of production — it was treated as a kind of equipment indispensable for initiating the economic process. Housing entered the category of the costs of investment and production, needed in the accounting of costs borne by the founder — the State — and was not a facility for its future user.

The main philosophy laying behind the organisational scheme of the Polish building industry up to 1990 was to recognise in the housing policy this limited function of the flat

— the function connected with the participation in the State's economic processes.

During the past 40 years this organisational scheme underwent some changes — part of the costs of building the houses was transferred to households (at the beginning of the 1960s the building co-operatives were reactivated), the system of loans was introduced, the building technologies and organisational schemes were changed — but the main rules of organisation of investment and financing of the building industry, connected with the decisive role of the State and the aims of

'Housing sector catastrophe'

industrialisation, were not changed.

The existence of privately-owned farms is a special characteristic of Poland and the private builders were allowed to meet the needs of private farming.

Thus during the whole period from 1950 to 1990 the organisational scheme of the building industry was composed of two sub-systems — the non-private (state, co-operative) sub-system and the private sub-system.

Until the middle of 1980, the connections between the members of those two sub-systems were minimal and consisted only of the possibility for private contractors and investors to buy building materials at a consumer's market price. Usually this possibility was connected with the administrative allotment system.

The real aims of the participants in

the building processes and the way the organisational scheme had worked led both to a low level of efficiency of the system and to the existence of a permanent shortage of supply in relation to demand.

The demand for building services, and resources for meeting demand

The housing sector of the economy in Poland is in a very bad position. In this respect, the word "catastrophe" is a more adequate expression than "crisis".

The shortage of supply is now estimated at about six million flats. Approximately 2.2 million adults are waiting in the "co-operative queue". At the same time about two million flats should be demolished because of the poor technical condition of the buildings. The yearly average number of flats which are no longer suitable for habitation is about 230,000. By contrast, between 1982 and 1988 about 185,000 new flats had been built annually, but in 1989 the output of the building industry fell to about 150,000 flats. The average number of flats per 1,000 inhabitants in 1989 in Poland was 284, in Czechoslovakia 373, in Hungary 370, in Austria 429, in West Germany 488.

About 45% of all flats are privately owned, 25% are owned by co-operatives, 19% by the State and 11% by companies (institutions, industrial works).

About 65% of all flats are situated in towns. The average standard of facilities is low. Differences depend mainly on location. In the towns 7% of flats lack a water supply, 17% have no WC, 21% have no bathroom and 30% are not connected to a central heating system. In the countryside as many as 43% of the flats have no pipeline water supply

and 61% lack a WC. Many villages have no potable water supply at all.

During the whole period of the socialist economy system in Poland the number of flats being built was the result of the industrialisation policy, closely connected with a doctrine saying that control of the means of production was the main determinant of economic growth.

This rule was broken for the first time at the beginning of the 1970s when the régime of Mr Gierak recognised the need for growth of the consumer goods industry (including the building of flats). Nevertheless, the priority of heavy industry was still maintained.

The change in the doctrine was not followed by changes in the functional system of the economy and administration and after the initial

'Priority for industry'

successes (helped by huge loans from abroad) the economic collapse came. In the building industry the crash occurred in 1979.

In the years 1971-78 about seven flats per 1,000 inhabitants were built annually. The number in 1982 was 5.1, in the period from 1983 to 1988 about five and in 1989 only four. The total number of flats constructed fell from 284,000 in 1978 to 186,000 in 1982 and 150,000 in 1989.

The decrease was largest mostly in the urbanised regions and in the co-operative building organisations (a decrease of 45% compared with 1978). The trends for the years 1977-88 are shown in Table 1.

The volume of housing facilities in Poland as shown by the number of flats per 1,000 inhabitants is one of the lowest in Europe. In Poland this index in 1987 was 5.1, in Bulgaria 7.1, in Czechoslovakia 5.1, in the Netherlands 7.9, in East Germany 12.9, in Hungary 5.4, in the USSR 8.0.

The main cause of the deepening crisis in the Polish building industry can be attributed to the faulty organisational system of the industry. The main goal of the system was to maximise the volume (output) of the co-operative building sector notwithstanding the costs (decision-making was not based on upon economic considerations).

From 1982, when elements of the market system were introduced into the strictly centralised organisation of the building industry, the contradiction of interests between contractors and investors became intolerable. Previously, the conflicts had been smoothed by the directives of the plan. The goal of activity of the contractor was to maximise production as to the financial volume (because he was motivated thus by the fiscal price and administrative distribution systems). The goal of the state and the co-operative investor was to achieve the flat regardless of costs — because the investment resources (loans and grants) were made by the State (at a central level). No mechanism (such as a market) existed which would stimulate both participants of the building process to be more rational and to be more economically efficient.

The connections between the co-

operative investor and the private contractor were made difficult by the administrative mechanism.

Until 1982 almost 95% of investment resources for building houses had been accorded to the state-owned and the co-operative sector. After 1982 the participation of these sectors decreased to the present level of 70%.

It should be stressed that the co-operative investor did not (and still does not) mean an individual member of the co-operative. The individual member of the co-operative was (and still is) deprived of all his

'Maximising production'

rights. All the loans and grants were given (by law) to the co-operative, not to its members. The co-operatives were the huge, centralised organisations (with regional and central unions), uncontrollable and unable to work efficiently (because of the easy way they received central grants). This organisational scheme caused the volume of production of the building industry (the number of flats built) to depend directly upon the resources (raw materials, man-

44 →

Table 1.
Flats Built, Poland, 1978-88

<i>Number of flats built</i>	<i>Year</i>			<i>Growth Rate</i>	
	<i>1978</i> <i>000</i>	<i>1982</i> <i>000</i>	<i>1988</i> <i>000</i>	<i>1978/88</i> <i>%</i>	<i>1982/88</i> <i>%</i>
Total volume	283.6	185.4	198.6	-33	+ 2
Public sector	209.3	130.0	125.5	-40	-12
incl. co-operative sector	157.2	98.0	85.9	-45	-12
Private sector	74.3	55.4	64.1	-14	-16
in towns	29.2	21.6	26.5	- 9	+23
in villages	45.1	33.8	37.6	-17	+11
Proportion of the private sector in the total volume	26.2	29.9	33.8	—	—
Proportion of the co-operative sector in the total volume	55.4	52.9	45.3	—	—

← 43

power, loans and grants) allocated to the housing sector by the central plan and budget. Thus the crash of the economy after 1980 brought with it automatically the crash of co-operative housing investments.

The system of financing the building industry

The financing of the housing sector was determined by the organisational scheme of the building industry. The financing system which existed until 1990 consisted of two sub-systems:

- (a) The sub-system for the public building industry (co-operative, state- and company-owned housing).
- (b) The sub-system for the private sector.

In the public sector the investor role was played by co-operatives (not the members themselves), local authorities and companies. In the

'Crash of co-operatives'

private sector the investor was the individual person.

The ways of obtaining plots of land, preparing the technical documentation, obtaining the materials and the investment resources as well as the terms of financial credits were different for the two sub-systems. The common point for both was a complete isolation of financing from the institution of mortgage. The debt on a mortgage was applied only in a case of repairs of privately owned houses.

The member of the co-operative was, in an obligatory way, represented by the co-operative. The co-operative was granted the plots of land, usually free of charge, by the local authorities. The co-operative obtained loans and building materials. The grants for the members were directed to the banking

account of the co-operative. The member was obliged to pay a certain amount of money as a "basic deposit". The amount of deposit depended on the right of possession needed by the member, amounting to 10% in the case of a so-called "lodger-flat" and to 20% in the case of an "owned flat". (The "lodger" type of flat is owned by the co-operative. For the "owned" type of flat the owner has limited property rights — he can sell but the co-operative has the right of pre-emption.) The rest of the money was supplied by the State grant given in a form of a "premium of guarantee" which revalued the deposit according to the cost of the flat and of a "systematic saving premium" amounting to about 40% of the deposit. The difference between the cost of the flat and the deposit (plus grants and interest on a deposit) was covered by the loan given on preferential terms by the State. The interest rate on such loans was 1% in the case of a "lodger-flat" and 3% in the case of an "owned flat".

The present system of financing differs slightly from the previous one. The part of the state grant — the "systematic saving premium" — was cancelled. The amount of the "basic deposit" was raised up to 15% and 30% respectively. There is no longer any preferential-term loan. The interest rate on building loans is the same as for any other economic activity. The only exception is the case of co-operative flats which had been built up to 1990. The interest rate in this case is 115%, but 32% is paid by the State, 8% by the co-operative and 60% is added to the actual amount of the debt. Actually, the rate of interest is calculated separately for each month, but in the second half of 1990, as a result of controlling the inflation rate, a quarterly interest rate is expected.

In the previous system the private investor could also obtain the preferential-rate credit. The interest

rate was 3%. The main obstacle in the development of private building thus was not the cost of the loan but that the total amount of money allocated was insufficient in relation to demand. About 90% of all loans were allocated to the public sector. In addition, there was no legal way to obtain a loan on commercial terms. Actually, the private investor is given loans on commercial, not preferential, terms.

The rules of financing the co-operative forms of housing were also applied to state-owned (municipal) and company-owned housing. (State-owned houses account for 3% of the total stock and company-owned houses for 17.5%.)

Until 1990 the State participation in the financing of building and maintenance costs of housing (rent subsidies and subsidies for maintaining infrastructure) amounted to about 60%. It is very hard to calculate the actual rate of participation of the State. In 1990, despite strong limitations on the volume of preferential-term loan and grants, about 53% of the allocated sum (11.1 billion zlotys) represented subsidies to the maintenance of the municipally-owned houses and to central heating of the flats. The rest is spent mainly on the revaluation of the basic deposits belonging to the

'Central regulation'

members of the co-operatives waiting for their flats.

The present system of financing the building industry still bears the attributes of the socialist economy, preferring the co-operative sector of housing and centrally regulating the volume, the structure of ownership and the physical aspects of housing. The task of adapting this system to the market economy is in progress. The basic problem is to reconcile the market rules of operation with the intervention of the State, indis-

pensable because of the poverty of the society.

The main direction of the system of financing points towards abolishing the rule of a single loan source (loans granted by the State) and a single bank. The creation of investment banks and financing institutions which can issue loans secured by mortgage is planned as well as creating the possibility of borrowing money for purchasing (and not only for building) a flat.

Determinants of housing policy of the 1990s

There is currently no plan for a future housing policy. The lack of such a plan is the consequence of the destabilisation of the economic and political state of Poland.

The general and thorough reform of the functional system of the economy and administration is in progress. Its general presumptions are the introduction of the real market economy, the decentralisation of state administration, and the "socialisation" of control of the economic processes (transfer of control to the local authorities). For the housing and the building industry the general presumptions point towards the actions which have to be taken: the privatisation of building enterprises, the freeing (from the economic point of view) of investors, and giving local authorities power over the building process in their regions. The formulation of concrete rules for the future housing policy is not possible before the conclusion of reforming the system.

Currently, the main goal of the government's economic policy (known as "Balcerowicz's programme") is to stop inflation and to balance demand and supply. The structural causes of inflation (the lack of a real market, administrative ways of allocating resources, the centralised system of planning and management) which appear in the conditions of very intense shortages of resources (both physical and financial) induce attainment of the positive effect of stabilisation activi-

ties — the balance of supply and demand on the market — at very high level of prices for goods and capital and very low level of salaries (average approximately \$70 a month) only. That is the situation today.

The basic monetary character of the financial policy means that prices have stopped at a level determined by the low effective demand and the simultaneous decrease in supply. For the building industry the high cost of a loan and cancellation of most State subsidies has resulted in a general decrease of building activity and the general decrease of effective demand.

The potential increase of demand for flats depends on two basic factors:

- (a) The increase in the availability of loans (reduction of interest rates, increase in the amount of money available).
- (b) The decrease in the operational costs of building enterprises (an increase in their economic efficiency).

Currently, the cost of loan finance is still very high, inhibiting the growth of the building industry. To speed up this growth the introduction of a whole system of financial infrastructure is needed, eg:

- (a) Restitution and an actualisation of the cadastral registers and an efficient system of registration of loan and properties.
- (b) Creation of investment and mortgage banks.
- (c) Creation of a capital market for the building and housing industry.
- (d) Development of the system for financing the housing and building industry, defining the role of the State and the local authorities.

Work to develop these facilities is in progress. A decrease in the operational costs of building enterprises (contractors) means precisely to create the conditions which result in

an increase in efficiency — ie, the restitution of the real market.

Currently, the building enterprises operate from their monopolistic positions — because the demand for building services exceeds the supply — and by the means of price increases could compensate any non-rational activity. A large decrease in demand from investors (cancellation of state subsidies, increased loan costs) forced investors to cancel many planned investments. The number of new orders dropped significantly (by approximately 60%), and many investors did not pay for the projects which had been started in the past. The financial standing of the building enterprises (contractors) becomes worse each day. It is acknowledged that about 15% of the enterprises building houses are on the edge of bankruptcy. The actual number is probably much higher. To stay in the market, these contractors have to

'Decrease in output'

restore their financial health. However, this takes time. The process of general privatisation of the economy should shorten this time.

Taking into account the time needed for preparation of the financial infrastructure indispensable for the normal functioning of building investors and the time needed for privatisation and restructuring of contracting enterprises, it seems that a real restart of the Polish building industry can be expected only in the middle of 1991. Until this time the decrease in output of the building industry, in particular of the building of flats, can be expected to continue. ■

IRENA HERBST is an economist with the Institute of Organisation, Management and Economics of the Building Industry, Warsaw, Poland.