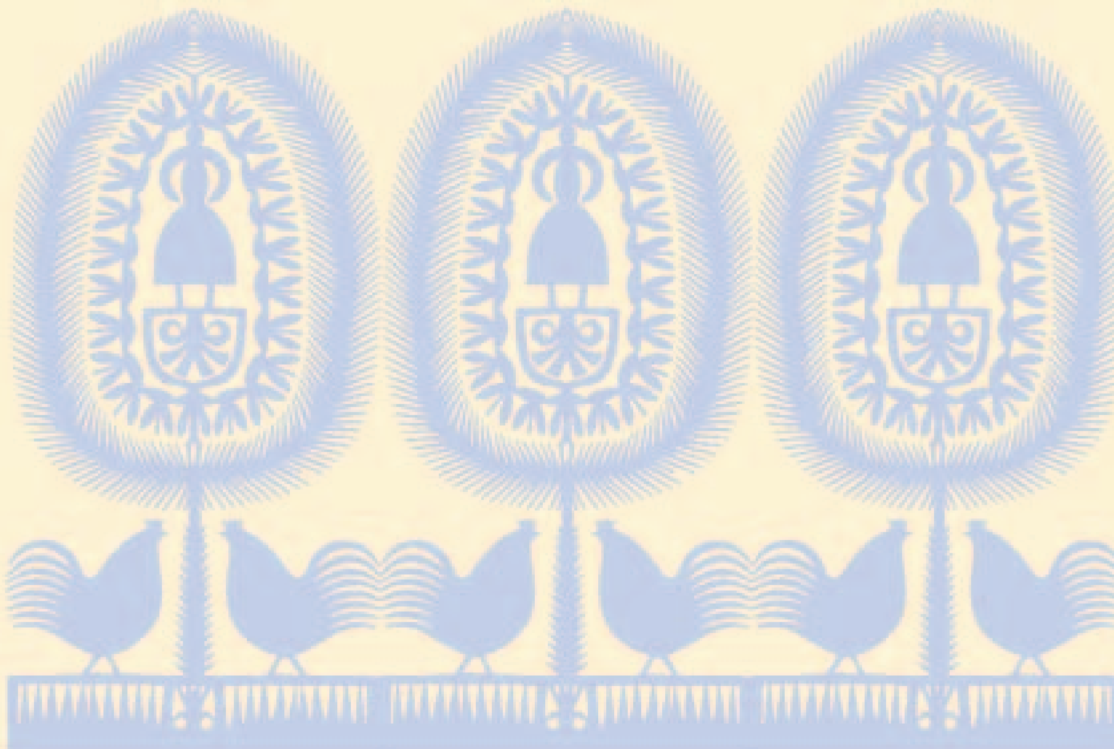
# ANNUAL REPORT **2001**. PUBLIC DEBT.

MINISTERSTWO FINANSÓW



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## INTRODUCTION

*The Ministry of Finance's publication Annual Report Public Debt 2001 has been prepared with the aim to acquaint the Readers with matters referring to the national public debt, the reasons for incurring financial commitments, methods of the State Treasury debt management and also execution of respective provisions of the State Budget Act from perspective of debt manager's activities. Distinct from the previous publications, the national public debt is the core subject of the Report due to its significance and consequences of its servicing for the county's economy (and not, as it has been the case so far, narrowed to Treasury securities issues). The subject of the Treasury securities has not been left out since the national debt results mainly from issuing Treasury securities. The Treasury securities market is discussed in detail in the Annex constituting an electronic enclosure to this Report. Thanks to this approach we were able to create a specific compendium of knowledge on the essence and instruments of incurring public debt, its history and servicing.*

*The Annual Report 2001 consists of three chapters and an Annex provided only in an electronic form. Chapter 1 presents general legal basis regulating debt incurring by entities of the public finance sector. The genesis of the debt in the post-war Poland is presented together with detailed analysis of the public finance sector debt and of the State Treasury debt in particular. It concentrates on changes of the level and structure of the debt, as well as on the costs of the State Treasury debt servicing in 2001.*

*Chapter 2 focuses on explaining what the Public Finance Sector Debt Management Strategy is, what objectives are to be reached by the public debt management together with effects of their achievement in the previous year.*

*Chapter 3 explains the state budget borrowing needs and points out sources of their financing. The execution of the state budget borrowing needs financing in 2001 is also presented in a comprehensive way.*

*The electronic Annex to the Report is a new element of this year's publication. It covers, among others:*

- *complete set of legal acts governing the debt drawing and servicing, as well as issuing of the Treasury securities,*
- *description of debt instruments offered currently by the Minister of Finance together with a characteristics of earlier issues and with a description of their sales methods,*
- *a report on events that took place in the area of Treasury securities issuance, including, first of all the sales on the primary market and the secondary market performance of these securities in the year 2001.*

*In order to provide the Readers with increased transparency and improved visualization of the problems discussed, the Report includes tables with detailed figures and is illustrated with charts.*

# CHAPTER I. Public Debt

## 1.1. Legal basis of the national public debt

General principles pertaining to the national public debt are regulated in the Republic of Poland Constitution, Chapter X – Public Finance.

Above all the Constitution introduced the rule that no loan can be taken or guaranty or surety extended in consequence of which the national public debt will exceed the 3/5 of Gross Domestic Product. The exclusive right of legislative motion as to Budget Act as well as to budget provisional arrangement act is on the side of the Council of Ministers, amendments to the Budget Act, act regulating the public debt incurring and act on sureties and guaranties granting by the State Treasury.

Furthermore, the Constitution of RP prohibits budget deficit financing by incurring financial commitments in the central bank.

The fundamental legal act comprehensively regulating the national public debt is the Act of November 26th, 1998, on public finance (Journal of Laws, No. 155, item 1014, as amended). It regulates the issues of:

- The subject and object scope of public finance,
- Basic definitions pertaining to the national public debt,
- Rules for the national public debt calculation,
- Financing of state budget borrowing needs ,
- Prudential and rehabilitation procedures,
- General principles of incurring financial commitments by the public sector finances entities,
- Principles and procedures of issuing securities and drawing credits by the State Treasury.

## 1.2. Definition of the national public debt

The national debt includes the nominal debt of public sector entities established after allowing for financial transfers between entities of this sector (consolidated gross debt).

The state public debt is calculated at face value.

The value of issued securities is calculated according to their face value, which is understood as the total of principal of issued securities due at the redemption date.

The value of credits and loans drawn is calculated at face value, which is understood as a total of credit or loan principal payable at the due date.

The value of deposits accepted is calculated as an amount of deposits to be returned at the term stipulated in the agreement of deposit liquidation date. This is also the base value for interest calculation.

The value of due obligations with exclusion of obligations arising from granted guaranties and sureties includes the total value of obligations, with exclusion of interest overdue but which are neither prescribed nor written off.

The face value of indexed or capitalized liabilities (for instance bonds or credits with capitalized interest) responds to face value (of principal) with consideration of increase in capital caused by the indexation or capitalization mechanism, as calculated at the end of reporting period.

Debt expressed in foreign currency shall be recalculated into national currency at the average exchange rate of foreign currencies as quoted by the National Bank of Poland at the last working day of given reporting period.

## 1.3. The subject scope of the national public debt

The national public debt includes obligations of the public finance sector arising from the following debt titles:

1) securities amounting on cash benefits only (with exclusion of share securities), with consideration of short term and long term securities,

2) loans (including securities with restricted transferability), with consideration of short term and long term securities,

3) credits, with consideration of short term and long term,

4) deposits accepted, with consideration of transferable deposits (of immediate transferability) and other deposits,

5) due liabilities, in particular resulting from laws and court rulings and extended guaranties and sureties.

Minister of Finance defined in a ordinance detailed principal of classification of debt types included in national public debt, in this within State Treasury debt, taking into account basic categories according to type of debt by entities and objectives as well as maturity terms.

## 1.4. The object scope of the national public debt

The proper description of public finance sector is above all meaningful for establishing of the size of deficit of public finance sector as well as for the national public debt. The Act on public finance sets up a definite catalogue of entities classified as public finance entities.

The following entities are included into public finance sector:

1) Public authority bodies, government administration bodies, state control and law bodies, courts and tribunals, as well as local government units and its bodies and their associations.

2) Budgetary entities, including budgetary units, budgetary establishments and auxiliary establishment of budgetary units.

3) Earmarked funds.

4) The State higher education facilities.

5) Research and development units.

6) Self-managed public healthcare establishments.

7) The state or local government cultural institutions.

8) The Social Security Institution, the Farmers Social Insurance Fund and funds managed by them.

9) Healthcare Funds.

10) The Polish Academy of Science and its organizational units.

11) The central or local government legal entities established under separate acts to fulfill public tasks, with exclusion of enterprises, banks and commercial law companies.

Nowadays there is no legal framework for detailed division of public sector finance into sub-sectors. Up to January 2001, there was, though, the act providing for a division of public sector into government and local government sectors. For the purposes of this Report a division into the following sectors can be employed:

- Government sector, including public authority bodies, government administration bodies, the state control and law protection bodies, courts and tribunals, Polish Academy of Science and its organizational units, The Social Security Institution, Farmers Social Insurance Fund and funds managed by these, the Healthcare funds and units listed in item 2 – 7 and 11 for which the founding or supervising body there is a government administration body or other units included in government sector.

- Local government sector, including local government units and its bodies as well as their unions and units listed in items 2, 3, 6, 7 and 11, for which the establishing or supervising body there is a local government unit.

### 1.5. Means of Influence on the Public Finance Sector Debt

Minister of Finance has the powers imposed with the Act of November 26th, 1998, to supervise the Constitutional principle that there shall not be loans received or guaranties or sureties extended, in consequence of which the national public debt would exceed 3/5 of GDP. Basic rules for public debt management, prudential and rehabilitation procedures introduced in the case of excessive indebtedness provided for in the Act on public finance, are meeting the requirements defined in Constitution's Art. 216 as well as so called convergence criteria of European Union stipulated in Maastricht Treaty (European Union Treaty), pertaining to, among others, the relation of the national public debt and Gross Domestic Product.

In accordance with Maastricht Treaty and attached Protocol on the procedure applied in the case of excessive deficit, Member States are obliged to maintain the national public debt at the level not exceeding 60% of Gross Domestic Product (GDP). The Constitution of the Republic of Poland and provisions of Act on public finance are imposing still stronger restrictions, namely the relation between the national public debt with anticipated payments arising from guaranties and sureties granted by public finance sector entities shall not exceed 3/5 of GDP. To this effect the Minister of Finance has adequate powers enabling him to manage the national public debt properly.



One of the crucial topics of management of public debt, and in broader sense of public finance, is to extend of the time debt management horizons. Both volume and the structure of public debt are not susceptible for modifications in short term. This is resulting out of the fact that public debt is an effect of appearance of budget deficit in longer periods and therefore it is impossible to reduce the debt volume in few years. Extension of the time horizons of public debt management is therefore of surmounting importance. This postulate has its reflection in the Act of November 26th, 1998, on public finance provisions. There were introduced the concepts of the State Treasury debt management strategy and the national public debt, as well as of the strategy of influencing the public finance sector debt.

The Minister of Finance is entitled to prepare such a strategy and to submit it for the consideration of the Council of Ministers, which upon acceptance of this body, would be submitted to the Parliament along with justification to the State Budget Act. The distinction between the concepts of "management" and "influence" stems from the fact that in relation to the State Treasury debt the Minister of Finance has decisive powers which amount to management of this financial aggregate. With respect to public finance sector units which debt is included into the national public debt and not being a debt included into the State Treasury debt – mainly then debt of government sector units – there are indirect form of influence only.

Because of the above considerations, into the Act on the public finance there were introduced the following restrictions as to taking obligations by the local government units and other public finance sector entities, which have an influence on the amount and the shape of their debt:

- Local government units (LGU) can draw credits and loans and to issue securities for purposes named in the Act only.

- These credits and loans as well as issued securities by the LGU which are intended to cover the current deficit shall be redeemed or repaid in the same year they were drawn or issued.
- The funds obtained from drawing credits and loans and issuing securities with maturities longer than one year can be used exclusively for financing of investment expenditures not covered in the planned income of given local government unit.
- The cost of servicing of long term obligations drawn by the local government units shall be borne at least once a year, while the discount on issued securities shall not exceed 5% of face value.
- There is not allowed an interest capitalization on credits and loans or guaranties or sureties extended with pay off or repayment term longer than one year.
- Local government units and other public finance sector units, with exclusion of the State Treasury, can only incur financial commitments whose maximum nominal value, denominated in PLN, has been set at the date of transaction.
- If a local government unit applies for credit or a loan, or intends to issue securities, the regional accounts chamber shall deliver opinion on the ability of credits, loans or securities repayments.
- Regional accounts chambers submit their opinions on feasibility of deficit financing plans presented by local government units and as to regularity of attached forecasts of the local government units debt. This opinion is announced to the public. Should there be the negative opinion of said regional accounts chamber, the legislative body of the local government units is obliged to take an appropriate resolution.
- A total arising from all credits and loans principal payments due in given financial year and possible payment arising from guaranties granted by the local government units along with interest on these credits due in given year and interest due on discount as well as redemption on expiring securities, shall not exceed 15% of planned incomes of local government unit for given budget year.
- Should the total of the national public debt with allowance for an amount of expected payment arising from guaranties and sureties extended by public finance sector entities exceed 55% in relation to GDP, then the amount of total payments arising from servicing of debt in given year shall not exceed 12% of planned incomes of this local government unit, unless these burdens are in full arising from obligations taken before announcing of this relation.
- The total indebtedness of local government unit at the end of budget year shall not exceed 60% of this unit's incomes in this year.

Due to the actual possibility to monitor the relation between the national public debt and Gross Domestic Product by the Minister of Finance, as adopted in the Act, among others through the reports of public finance sector entities pertaining to the national public debt, is assumed that implementation of the Constitution's norm with this respect will be performed mostly at the ground of prudential procedures.

The expected prudential and rehabilitation procedures pertaining to the relation of the national public debt increased by anticipated disbursements on guaranties and sureties are as follows:

**1) The relation is greater than 50%, and less than 55% of GDP:**

a) A restriction on the relation of the state budget deficit to its incomes is introduced and such an relation adopted by the Council of Ministers in a the state budget bill for the next year shall not be higher than in the current budget year.

b) The relation of deficit to incomes as established in the state budget for the next financial year, which can be adopted for budget year, constitutes the limitation for every local government unit.

**2) The relations bigger than 55%, and below 60% of GDP:**

a) The state budget bill submitted by the Council of Ministers shall provide for diminishing of the relation of the amount of the State Treasury debt, including anticipated disbursements on guaranties and sureties extended by the State Treasury, to GDP in the next budget year. Planned state budget deficit and increase of the State Treasury debt shall provide for diminishing of this relation in the next budget year.

b) There are imposed limitations on all deficits of the local government units, possible to adopt by them.

c) The Council of Ministers presents the program of rehabilitation, aimed at diminishing of the relation of national public debt, increased by the anticipated disbursements on guaranties and sureties granted by the public finance sector entities, to GDP.

**3) The relation is equal or higher than 60% of GDP:**

a) In the budget bill for the consecutive budget years there are no provisions for the state budget deficit and local government unit's budgets are adopted without any deficits.

b) The prohibition on granting of new guaranties and sureties.

c) The Council of Ministers submits to the Parliament the rehabilitation program, the main part of which there is a program of undertakings aimed at diminishing of the said relation below 60% of GDP.

## 1.6. General Principles of Incurring Financial Commitments and Issuing Securities by the State Treasury

General principles of incurring financial commitments and issuing securities by the State Treasury are regulated by Part II of the Public Finance Act, named The National Public Debt.

The exclusive right to issue Treasury securities with cash benefits as well as raising of credits and loans in the name of the State Treasury, is assigned to the Minister of Finance.

Excluded are loans or credits drawn under international agreements requiring the government to be a debtor and should it be the case, the Council of Ministers empowers the Minister of Finance to sign the agreement and stipulates conditions of its execution.

The amount of raised loans and credits and the value of the issues of the Treasury securities are limited with the yearly budget acts.

The Treasury securities, to issue of which the Minister of Finance is empowered, are hereby divided with respect of redemption term:

- Short-term – Treasury bills offered on the domestic primary market at a discount and redeemed at the face value. Maturity term up to 364 days (inclusive).
- Long-term – Treasury bonds offered on the domestic and international markets bearing interest in the form of discount and/or coupon. Maturity term over one year (over 365 days).

The Act on public finance, allows the Minister of Finance to issue, on behalf of the State Treasury, the following Treasury securities:

1) Treasury bonds, which are understood as a securities offered for sale on domestic or foreign markets bearing interest in the form of discount and/or coupon.

2) Treasury bills, which are understood as short term securities offered for sale on the domestic primary market at a discount and redeemed at face value, after the term, for which it was issued.

3) The Treasury savings bonds, which are understood as Treasury securities offered for sale exclusively to domiciled private persons (so called residents), and after joining the EU to non-residents as well.

General terms of issuance of Treasury securities are set in ordinances, as the detailed terms are announced in the Issue Letters published by the Minister of Finance. The issue is effective only after the Issue Letter is announced to the general public. As such an announcement it is considered both the publication of the Issue Letters in press of nationwide circulation and on the Internet pages of Ministry of Finance.

Under the delegation laid down in Art. 55 of The Public Finance Act, the Minister of Finance issued five ordinances in 1999, governing the general conditions of issuing specific instrument groups:

1) Minister of Finance Ordinance of April 26th, 1999, on general conditions for issues of Treasury bonds offered at auctions (Journal of Laws No. 38, item 368, as amended).

2) Minister of Finance Ordinance of April 26th, 1999, on general conditions for issues of Treasury bonds offered for sale at retail network (Journal of Laws No. 38, item 369, as amended).

3) Minister of Finance Ordinance of August 26th, 1999, on the conditions for issuing of Treasury bills (Journal of Laws No. 74, item 831).

4) Minister of Finance Ordinance of September 7th, 1999, on conditions for issue Treasury bonds for sale on foreign markets (Journal of Laws No. 75, item 845).

5) Minister of Finance Ordinance of September 8th, 1999, on conditions for issuing Treasury bonds for conversion of the State Treasury liabilities (Journal of Laws No. 74, item 834, as amended).

The ordinances specify the options available to the Minister of Finance in determining detailed conditions of issue. They set forth the general conditions of instrument design, sale procedures, investor groups to which the Treasury securities are offered, terms of servicing and redemption (including buy-back and early redemption).

Owing to the fact that Treasury securities are a form of borrowing, their disposal on the primary market is performed against a fee, after the payment by the investor of an amount determined based on the sale price and number of Treasury securities purchased. The issue of TS is effected at a date of payment for the securities subscribed for. The number of TS issued is equal to the number of TS sold.

Under the Act, redeemed bonds are cancelled. Only the TS repurchased by the State Treasury for the purpose of State Treasury debt management are not subject to cancellation.

## 1.7. Public debt - Past and Present

The level of the national public debt is one of the basic elements significantly influencing the economy of any given country. Presented in the relation to Gross Domestic Product, the public debt is one of the most important macroeconomic indicators used for assessment of the standing of the economy and the public finance stability in a given country. On the basis of this indicator one can appraise whether the country has the ability to meet its obligations without disturbances. The higher is its level, the higher also is the cost of its servicing, which can be a factor causing further deepening of the budget deficit. Persisting and even growing deficit causes increase of debt servicing costs and this becomes the more and more significant item of budget expenditures. These are rigid expenditures, because their amount is closely tied with face value of the debt and conditions of the issue of particular security.

Up to the beginning of '70s foreign indebtedness of Poland[1] in convertible currencies was not excessive, in 1971 it amounted to USD 987 mn. Due to limited

[1] Up to 1989 Poland's foreign indebtedness was in the from of direct State Treasury's obligations.

foreign trade and financial relations with the developed countries this level of debt was possible. As an effect of opening of Poland to the West from 1972 and a new economic policy, the debt began to grow. In 1980 the indebtedness level amounted to USD 24,128 mn. This was closely related to the possibility to draw new credits by Poland.

Between 1982 and 1989 Poland concluded with the official creditors (members of the Paris Club) and private creditors (members of the London Club) several agreements on postponing of credit payments already due. These agreements were of a great importance to Poland, because they provided for prolonged repayment of the existing debt and provided as well for raising additional small credits. Growing arrears in obligation payments were the main factor causing an increase of Poland's foreign debt in the 80's.

In 1990 Poland's the foreign indebtedness reached the level of USD 48,768 mn. In consecutive years the indebtedness level was diminishing and in 2001 it attained a total of USD 24,812 mn. In 1991 an agreement with official creditors, members of the Paris Club, was signed and in its outcome Poland's foreign debt was reduced in two stages, the first stage in 1991, and second stage in 1994. Also in the year 1994 an agreement with commercial banks, i.e. with members of the London Club, was concluded. These agreements were aimed at reducing the foreign indebtedness in terms of so called net present value, respectively by 50% in the case of Paris Club and to similar extend to London Club creditors (reduction included all payments – the principal and the interest).

For implementation of the agreement with commercial banks Poland issued on October 27th, 1994, the so called Brady bonds. These were six instruments with different features and different maturity dates.

In 1995 Poland made a debut on the international market issuing bonds denominated in USD for a total of USD 250 mn, with a 5-year maturity. In 1996 and 1997 there were two more issues on foreign markets, in 1996 - DEM 250 mn (5-year maturity), and in 1997 for a total of USD 100 mn (20-year maturity) and USD 300 mn (7-year maturity) – so called Yankee Bonds.

The following issues, took place in 2000, after a three year break, and it was a first Polish issue on the Euro market. These were bonds with a 10-year maturity and a total of EUR 750 mn. In 2001 Poland again issued bonds denominated in Euro for a total of EUR 1 bn, also with 10-year maturity.

There were two main sources of drawing foreign funds:

- Credits drawn from international financial institutions (in particular World Bank and European Investment Bank) assigned mostly for enhancing system transformation processes in Poland and they were used to restructure the Polish banking system, agriculture and mining, develop financial institutions, modernize and construct of roads as well as support the reduction of debt against the London Club;
- Bond issues on international financial markets which besides providing funds for budget deficit financing were aimed at strengthening Poland's position as a trustworthy issuer on foreign capital markets.

**Table 1. Polish Brady bonds***

| Type of instrument | Issue date | Redemption date |
|---|---|---|
| Collaterised Discount Bonds | October 1994 | October 2024 |
| Collaterised Par Bonds | October 1994 | October 2024 |
| Collaterised RSTA Bonds | October 1994 | October 2024 |
| Past Due Interest Bonds | October 1994 | October 2014** |
| Debt Conversion Bonds | October 1994 | October 2019** |
| New Money Bonds | October 1994 | October 2009** |

* Instruments issued in 1994 due to execution of the agreement on reduction and restructuring of Poland's debt in commercial banks of the so called London Club;
** the date of the last capital installment payment.

**Table 2. Polish foreign bonds on international markets ***

| Type of instrument | Issue date | Redemption date |
|---|---|---|
| USD denominated (7,75%) bonds | July 1995 | July 2000 |
| DEM denominated (6,125%) bonds | July 1996 | July 2001 |
| USD denominated (7,125%) bonds | July 1997 | July 2004 |
| USD denominated (7,75%) bonds | July 1997 | July 2017 |
| EUR denominated (6%) bonds | March 2000 | March 2010 |
| EUR denominated (5,5%) bonds | February 2001 | February 2011 |

* Instruments issued mostly for strengthening Poland's standing as an international market player and to create a benchmark for other domestic issuers.

The volume of internal indebtedness is directly connected with a program of establishing a market oriented economy which was started in 1989. It consisted of creating a capital and financial markets, including Treasury securities market, as well developing public debt management mechanisms.

The first issues of securities aimed at financing of borrowing needs of the state budget at the initial period of system transformation took place in 1989 – there were 60% bonds of internal state loan. Regular issues of government debt securities followed as of half of 1991 and these became the most important source of financing borrowing needs of the state budget.

Table 3. Treasury securities market history in Poland

| Type of Bond | Start of sale | End of sale | Redemption of the last pool |
|---|---|---|---|
| 60% bond of the internal loan | October 1989 | December 1989 | June 2000 |
| bonds exchangeable into shares of state-owned enterprises | December 1989 | April 1991 | December 2000 |
| Treasury bills | May 1991 | - | - |
| One-year indexed-linked bonds (IR/RP) | May 1992 | May 1999 | March 2000 |
| Three-year floating-rate bonds (TZ/TP) | July 1992 | - | - |
| Two-year fixed-rate bonds (OS/AS) | February 1994 | September 1999 | October 2001 |
| Five-year fixed-rate bonds (OS/PS) | February 1994 | - | - |
| Ten-year floating-rate bonds (DZ) | December 1995 | - | - |
| One-year fixed-rate bonds (RS) | July 1998 | October 1999 | October 2000 |
| Ten-year, fixed-rate bonds (DS) | May 1999 | - | - |
| Two-year fixed-rate savings bonds (DOS) | June 1999 | - | - |
| Four year indexed-linked bonds (COI) | October 1999 | - | - |
| Zero-coupon bonds (OK) | October 1999 | - | - |
| Five-year fixed-rate retail bonds (SP) | December 2001 | - | - |
| Twenty-year fixed-rate bonds (WS) | April 2002 | - | - |

## 1.8. Public Finance Sector Debt Analysis [2]

Analysis of the of public finance sector's indebtedness may be made under its division on central government and local government sectors. Amendment of the Act on public finance, which entered into force as of January 2001, allows to obtain exhaustive data on public finance sector entities debt, arranged in the way which made it possible to eliminate transfers between them. Due to the differences in the range of data available in particular reporting periods, the comparability of the presented data is limited.

[2] Provisional data as of May 20th, 2002.

Table 4. The national public debt in 2000-2001 (at face value, PLN mn) - before consolidation

| Item | XII 2000 | VI 2001 | XII 2001 | Structure XII 2001 | Change XII 2001 - XII 2000 | |
|---|---|---|---|---|---|---|
| | PLN mn | PLN mn | PLN mn | % | PLN mn | % |
| **The national public debt** | **288,327.2** | **296,955.9** | **314,683.3** | **100.0** | **26,356.1** | **9.1** |
| **I. Central government sector debt** | **278,950.1** | **285,764.8** | **299,847.8** | **95.3** | **20,897.7** | **7.5** |
| 1. State Treasury debt | 266,816.8 | 271,562.8 | 283,937.5 | 90.2 | 17,120.7 | 6.4 |
| 1.1 Domestic debt | 145,981.6 | 160,314.1 | 185,028.4 | 58.5 | 39,046.8 | 26.7 |
| 1.2 Foreign debt | 120,835.2 | 111,248.7 | 98,909.1 | 31.4 | -21,926.1 | -18.1 |
| 2. Other central government sector debt | 12,133.3 | 14,202.0 | 15,910.3 | 5.1 | 3,777.0 | 31.1 |
| **II. Local government sector debt** | **9,377.1** | **11,191.1** | **14,835.5** | **4.7** | **5,458.4** | **58.2** |
| 1. Local government units debt | 9,377.1 | 9,104.3 | 12,266.4 | 3.9 | 2,889.3 | 30.8 |
| 2. Other local government sector debt | N/A | 2,086.8 | 2,569.1 | 0.8 | 2,569.1 | - |

By the end of 2001 the public finance sector indebtedness (before consolidation) grew by PLN 26,356.1 mn, that is by 9.1% over the end of 2000. The greatest influence on this change had the growth of government sector debt by PLN 20,897.7 mn, which arose mainly from the increase of the State Treasury debt (by PLN 17,120.7 mn). The domestic indebtedness of the State Treasury increased by PLN 39,046.8 mn, while foreign debt decreased by PLN 21,926.1 mn.

There has been a relatively high increase of local government sector debt. Within 12 months it increased by PLN 5,458.4 mn, that is by 58.2%, which resulted from obtaining and introducing data on debt of entities supervised or managed by the local government units [3].

More and more comprehensive consolidation of public finance sector's indebtedness is possible due to the positive changes in the area of national public debt reporting. Before the year 2001 only partial consolidation of central government sector debt was possible. Data on the national public debt at the end of December 2001 allowed for consolidation across all public finance sector.



[3] These entities are: local government earmarket funds being legal entities, independent public healthcare establishments, local government cultural institutions and local government legal entities established under separate laws and for fulfilling public tasks, with exclusion of enterprises, banks and commercial law companies.

Table 5. The national public debt in 2000 – 2001 (at face value, PLN mn) - after consolidation

| Item | XII 2000 | VI 2001 | XII 2001 | Strukture XII 2001 | Change XII 2001 - XII 2000 | |
|---|---|---|---|---|---|---|
| | PLN mn | PLN mn | PLN mn | % | PLN mn | % |
| **The national public debt** | **280,473.8** | **285,692.9** | **302,089.2** | **100.0** | **21,615.5** | **7.7** |
| **I. Central government sector debt** | **271,096.7** | **278,072.3** | **291,320.5** | **96.4** | **20,223.8** | **7.5** |
| 1. State Treasury debt | 265,887.9 | 271,124.7 | 282,617.1 | 93.6 | 16,729.2 | 6.3 |
| 1.1 Domestic debt | 145,052.7 | 159,876.0 | 183,708.0 | 60.8 | 38,655.3 | 26.6 |
| 1.2 Foreign debt | 120,835.2 | 111,248.7 | 98,909.1 | 32.7 | -21,926.1 | -18.1 |
| 2. Other central government sector debt | 5,208.7 | 6,947.6 | 8,703.4 | 2.9 | 3,494.7 | 67.1 |
| **II. Local government sector debt** | **9,377.1** | **7,620.6** | **10,768.7** | **3.6** | **1,391.6** | **14.8** |
| 1. Local government units debt | 9,377.1 | 6,083.7 | 9,008.8 | 3.0 | - 368.3 | - 3.9 |
| 2. Other local government sector debt | N/A | 1,536.8 | 1,759.9 | 0.6 | 1,759.9 | - |

### 1.8.1. State Treasury Debt

Total State Treasury (ST) indebtedness includes all ST financial obligations towards domestic and foreign entities arising from issued securities, drawn credits and loans and due obligations [4].

ST indebtedness at the end of 2001 totaled PLN 283,937.5 mn of face value (that is ca. USD 71.2 bn at the exchange rate as of Dec. 31st, 2001: USD/PLN 3.9863). It increased compared to the end of 2000 by PLN 17,120.7 mn, that is by 6.4%.

From December 2000 data on the State Treasury indebtedness is presented according to the place of issue and to the resident.

#### 1.8.1.1. State Treasury debt according to the place of issue

ST indebtedness by the place of issue takes into consideration the place of debt contracting, independently on who is the creditor.

[4] Art. 10 of the Public Finance Act.

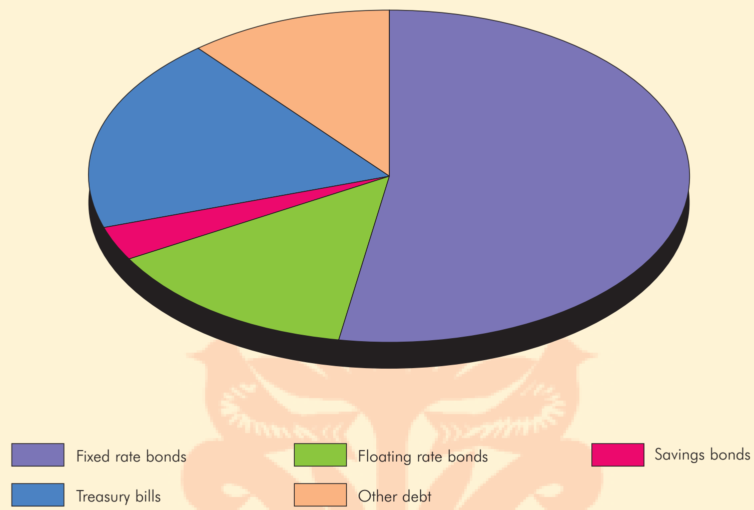
Domestic ST indebtedness by the place of issue as of the end 2001 totaled PLN 185,028.4 mn and in comparison to the end of 2000 it increased by PLN 39,046.8 mn. This debt consists of:

**1) debt in Treasury securities (TS) – PLN 176,048.4 mn (95.1% of domestic debt), in this:**

- debt in marketable TS – PLN 158,689.9 mn (85.8% of domestic debt),
- debt in savings bonds – PLN 6,058.3 mn (3.3% of domestic debt),
- debt in non-marketable TS – PLN 11,300.1 mn (6.1% of domestic debt),

**2) other debt – PLN 8,980.0 mn (4.9 % of domestic debt).**

Chart 1. Structure of domestic indebtedness of the State Treasury in accordance to the place of issue as of the end 2001




Among the most important changes in the structure of domestic indebtedness according to instruments in 2001 there should be emphasized:

1) Considerable increase of indebtedness in marketable fixed-rate bonds by PLN 22,114.3 mn, what caused their share to increase in domestic indebtedness from 51.7% as of end 2000 to 52.7% as of end of 2001.

2) Increase of indebtedness in Treasury bills by a total of PLN 11,773.3 mn making their share in domestic indebtedness increase from 16.1% as of end of 2000 to 19.0% as of end of 2001.

3) Increase of indebtedness in marketable floating-rate bonds by a total of PLN 7,297.2 mn, with simultaneous increase of these bonds in total domestic indebtedness from 12.8% as of end of 2000 to 14.0 % as of end of 2001.

4) Increase of indebtedness in savings bonds by a total of PLN 4,104.9 mn (i.e. by 210.1%), with increase of their share in domestic debt from 1.3% as of end of 2000 to 3.3% as of end of 2001.

5) Decline of indebtedness in non-marketable bonds by PLN 2,225.7 mn (i.e. by 16.5%) simultaneously the share of these instruments in domestic debt declined from 9.3% to 6.1%.

6) Decrease of the other State Treasury debt by PLN 4,017.2 mn, i.e. by 30.9% simultaneously the share of this debt declined from 8.9% as of the end of 2000 to 4.9% as of the end of 2001. This decline resulted from:

- Decline of due obligations by PLN 1,756.1 mn; such a significant decrease of this debt had an effect primarily: repayment on guaranty premium and credits interest refund on consumer housing (as of December 2001, expenditures earmarked for that purpose were enlarged by PLN 1,900.1 mn) and the continuation in 2001 of conversion of healthcare liabilities, taken over by the State Treasury (in 2001 the converted liabilities came to a total of PLN 338.3 mn);

- Decline in the amount of debt arising from the non-indexation of wages in the public sector by PLN 2,227.4 mn;

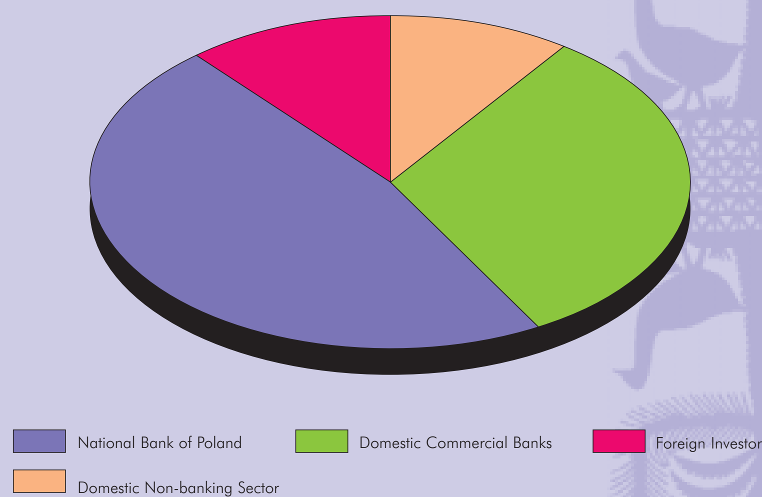
- Decline of liabilities against trade unions by PLN 151,4 mn as an effect of conversion (August and November, 2001) of these liabilities to the Treasury bonds for a total of, respectively, PLN 187.2 mn and PLN 3.7 mn.

From the subject structure of the State Treasury debt (allowing to define the main State Treasury creditors groups) in 2001 the following developments should be emphasized :

1) considerable increase of domestic indebtedness in the non-banking sector in 2001 by PLN 25,425.9 mn, i.e. by 41.3% in comparison to the end of 2000 to the amount of PLN 86,972.2 mn. Its share in domestic debt grew from 42.2% as the end of 2000 to 47.0% as the end of 2001;

2) increase of indebtedness against National Bank of Poland in 2001 by PLN 1,387.4 mn, i.e. by 8.3% in comparison to the end of 2000, to a total of PLN 18,169.0 mn. At the same time there was a decrease of this debt in the total domestic indebtedness from 11.5% as of the end of 2000 to 9.8% as of the end of 2001;

**Chart 2. State Treasury domestic debt by holder, end of 2001**



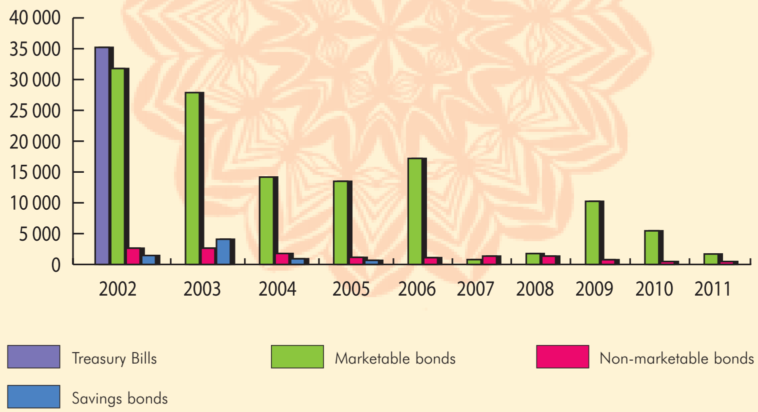

3) increase of domestic indebtedness in Treasury securities purchased by foreign investors in 2001 by PLN 2,991.1 mn, i.e. by 16.8% in comparison to the end of 2000 – to the amount of PLN 20,743.1 mn. At the end of 2001 the share of debt on the title of Treasury securities purchased by the foreign investors in domestic indebtedness showed 11.2% in comparison to 12.2% as of end of 2000;

4) increase of indebtedness towards domestic commercial banks by PLN 9,242.3 mn, i.e. by 18.5% in comparison to 2000, to the total of PLN 59,144.1 mn. The share of the debt against commercial banks in the total domestic indebtedness in 2001, in comparison to the end of 2000 decreased from 34.2% to 32.0%.

At the end of December 2001 the average maturity of the Treasury securities issued on the domestic market was 2.63 years against 2.51 years in December 2000. The average maturity profile for particular instruments was (in years):

- Marketable bonds – 3.12 (3.13 in December 2000);
- Treasury bills – 0.52 (0.34 in December 2000);
- Savings bonds – 1.61 (1.94 in December 2000);
- Non-marketable instruments – 2.97 (3.23 in December 2000).

Chart 3. Maturity profile of Treasury securities issued on domestic market




In the same period the duration for marketable Treasury securities issued on the domestic market denominated in PLN increased from 1.69 years (end of 2000) to 1.75 years (end of 2001) and was, respectively, for:

- Marketable bonds – 2.13 (2.05 in December 2000);
- Treasury bills – 0.51 (0.34 in December 2000).

In 2001 foreign indebtedness of the State Treasury according to the place of issue, expressed in USD decreased by USD 4,352.5 mn (decline by 14.9%) in comparison to the end of 2000 and amounted to USD 24,812.3 mn. The change of the indebtedness resulted from the repayment of the part of foreign financial liabilities, taking on new liabilities and change of the exchange rate of USD in relation to other currencies, in which the part of the State Treasury debt is denominated.

Table 6. Foreign debt of the State Treasury (USD mn, at the exchange rate as of the end of the year)

| Item | As of 31st December | | Change in 2001 | |
|---|---|---|---|---|
| | 2000 | 2001 | USD mn | % |
| The State Treasury foreign debt | 29,164.7 | 24,812.3 | - 4,352.5 | - 14.9 |
| 1. ST securities issued abroad | 5,439.5 | 5,861.7 | 422.1 | 7.8 |
| - Brady bonds | 4,362.4 | 4,048.1 | - 314.4 | - 7.2 |
| - foreign bonds | 1,077.1 | 1,813.6 | 736.5 | 68.4 |
| 2. Credits in convertible currencies | 23,725.2 | 18,950.6 | - 4,774.6 | - 20.1 |

| Item | As of 31st December | | Change in 2001 | |
|---|---|---|---|---|
| | 2000 | 2001 | USD mn | % |
| - Paris Club | 21,173.2 | 16,302.8 | - 4,870.5 | - 23.0 |
| - IFI* | 2,310.5 | 2,457.4 | 146.9 | 6.4 |
| in that: World Bank | 1,752.3 | 1,739.5 | - 12.8 | - 0.7 |
| - other creditors | 2,41.5 | 190.4 | - 51.0 | - 21.1 |

* International Financial Institutions (the World Bank, European Investment Bank, European Bank for Reconstruction and Development, Council of Europe Development Bank).

Table 7. Foreign debt of the State Treasury (in PLN mn at the PLN/USD exchange rate as of the end of the year)

| Item | As of 31st December | | Change in 2001 | |
|---|---|---|---|---|
| | 2000 | 2001 | PLN mn | % |
| The State Treasury foreign debt | 120,835.2 | 98,909.1 | - 21,926.1 | - 18.1 |
| 1. ST securities issued abroad | 22,536.9 | 23,366.4 | 829.4 | 3.7 |
| - Brady bonds | 18,074.3 | 16,136.8 | - 1,937.5 | - 10.7 |
| - foreign bonds | 4,462.6 | 7,229.6 | 2,766.9 | 62.0 |
| 2. Credits in convertible currencies | 98,298.2 | 75,542.7 | - 22,755.6 | - 23.1 |
| - Paris Club | 87,724.8 | 64,987.7 | - 22,737.1 | - 25.9 |
| - IFI | 9,572.9 | 9,795.9 | 223.0 | 2.3 |
| in that: World Bank | 7,260.1 | 6,934.0 | - 326.1 | - 4.5 |
| - other creditors | 1,000.6 | 759.1 | - 241.5 | - 24.1 |
| PLN/USD exchange rate | 4.1432 | 3.9863 | -0.1569 | -3.8 |

The State Treasury debt in 2001 was composed of two main items:

1) debt in Treasury securities – USD 5,861.7 mn (PLN 23,366.4 mn),

2) debt in granted credits – USD 18,950.6 mn (PLN 75,542.7 mn).

Debt in Treasury securities included debt in so called Brady bonds (issued in 1994 as an implementation of the agreement on reduction and restructuring of Polish debt against commercial banks grouped in so called London Club) and bonds issued on international financial markets.

Changes in foreign debt on the title of the State Treasury securities issues in 2001:

1) Decrease of debt in Brady bonds by USD 314.4 mn (PLN 1,937.5 mn) to the amount of USD 4,048.1 mn (PLN 16,136.8 mn);

2) Increase of debt in bonds issued on international financial market by USD 736.5 mn (PLN 2,766.9 mn), to the amount of USD 1,813.6 mn (PLN 7,229.6 mn).

At the end of the year 2001 the Brady Bonds' debt consisted of the following instruments: PAR (Collaterised Par Bonds), RSTA (Collaterised RSTA Bonds), PDI (Past Due Interest Bonds), DCB (Debt Conversion Bonds).

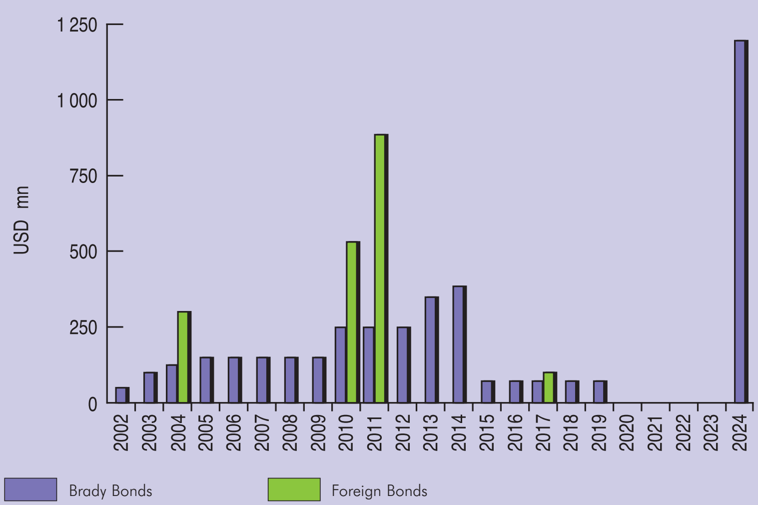
The change in the level of indebtedness resulted from an operation of a partial premature redemption of the RSTA bonds in April 2001 (of face value of USD 289.5 mn) as well as the repayment of the first principal installment on PDI bonds amounting to USD 24.9 mn. in October.

The amount of debt in the international capital markets bond issues as of the end of 2001 consists of two tranches of USD denominated bonds issued in 1997 and EUR denominated bonds issued in the years 2000 and 2001.

The change of indebtedness in these instruments is resulting from: the issue in February 2001 of 10 year bonds of EUR 750 mn in face value, December transaction of increasing of this above mentioned amount by EUR 250 mn, redemption of 5-year bonds issued in 1996 at face value of DEM 250 mn and changes of EUR/USD exchange rates.

The average maturity for all bonds issued on international markets (together with Brady bonds) was 11 years and 8 months as of the end of 2001 .

**Chart 4. Maturity profile of the Treasury securities issued on international capital markets**




Changes in foreign indebtedness in drawn foreign credits in 2001:

1) Considerable decrease of indebtedness against the creditors grouped in the Paris Club (PC) by USD 4,870.5 mn (PLN 22,737.1 mn) to the amount of USD 16,302.8 mn (PLN 64,987.7 mn);

2) Increase of debt against International Financial Institutions (IFI) by USD 146.9 mn (PLN 223.0 mn), which totaled as of the end of 2001 USD 2,457.4 mn (PLN 9,795.9 mn);

3) Decrease of indebtedness in other credits by USD 51 mn (PLN 241.5 mn) to the amount of USD 190.4 mn (PLN 759.1 mn).

The biggest part of the indebtedness in credits was the debt towards the Paris Club. This debt is serviced on a current basis since 1991. As of the end of 2001 this constituted for 65.7% of total foreign debt of the State Treasury. In the course of the year the State Treasury repaid the principal amounting to USD 811.1 mn and prematurely bought back a debt of USD 3,321.0 mn in face value (effectively paying for 74% of face value). The remaining part is an effect of the appreciation of USD exchange rate against other currencies in which the State Treasury debt is partly denominated (in the case of Paris Club just a 25.8% are liabilities denominated in USD).

Changes of indebtedness against IFI as of the end of 2001 were a product of three factors: taking on a new liabilities for a total of USD 427.9 mn, paying off of earlier debts for a total of USD 160.0 mn and US dollar rate of exchange changes to other currencies in which the debt against these institutions is denominated.

At the end of the discussed period there was a fall of the debt on other credits (this item includes small credits, among them credits taken for financing of investment in healthcare sector, in the construction and for a Polish banking privatisation fund), which arises mostly from successive repayment of the credits included in this item.

### 1.8.1.2. State Treasury debt according to the resident

Since December 2000 data on the State Treasury debt is also presented according to the resident, with further division on domestic (towards residents) and foreign (against non-residents) debt[5]. The foreign debt according to the resident takes into account all securities in the foreign investors' portfolio, independently of their place of issue.

As of end of December 2001 the domestic debt of the State Treasury (against residents) amounted to PLN 167,124.7 mn and increased in comparison with December 2000 by PLN 36,810.8 mn. In the same period the foreign indebtedness of the State Treasury (against non-residents) decreased by PLN 19,690.2 mn, to the amount of PLN 116,812.8 mn as of the end of 2001.

The share of foreign debt in the total State Treasury debt was 41.1% at the end of the 2001 in comparison to 51.2% as of the end of 2000. This was caused mainly by the decrease of debt in foreign credits (by PLN 22,755.6 mn), which had the

[5] The concept of the resident and non-resident are stipulated in the Foreign exchange law of of December 18th 1998 (Journal of Law of 1998, No. 160, item.1063, as amended)

dominant position within the foreign debt, with a share of 64.7%. The remaining 35.3% constituted for debt in Treasury securities, which increased by PLN 3,064.0 mn.

The marketable Treasury securities strongly dominated in the domestic debt (84.2%). The Treasury bonds issued on foreign markets and Brady bonds in the residents portfolio (mainly domestic commercial banks) amounted just to 1.7% of total domestic debt only.

The differences in proportion of foreign debt in total State Treasury debt according to the resident and to the place of debt issuing resulted from the fact that the foreign investors (non-resident) had a higher participation in the Treasury securities issued on the domestic market, than domestic investors (residents) had in the Treasury securities issued on the foreign market.

**Table 8. State Treasury debt according to place of issue (in face value in PLN mn)**

| Item | XII 2000 | Structure XII 2000 | XII 2001 | Structure XII 2001 | Change XII 2001 – XII 2000 | |
|---|---|---|---|---|---|---|
| | PLN mn | % | PLN mn | % | PLN mn | % |
| **The State Treasury Debt** | **266,816.8** | **100.0** | **283,937.5** | **100.0** | **17,120.7** | **6.4** |
| **I. Domestic debt** | **145,981.6** | **54.7** | **185,028.4** | **65.2** | **39,046.8** | **26.7** |
| 1. Debt in Treasury securities (TS) | 132,984.4 | 49.8 | 176,048.4 | 62.0 | 43,064.0 | 32.4 |
| 1.1 Marketable TS | 117,505.2 | 44.0 | 158,689.9 | 43.5 | 41,184.8 | 35.0 |
| - Treasury bills | 23,442.3 | 8.8 | 35,215.6 | 12.4 | 11,773.3 | 50.2 |
| - Treasury bonds | 94,062.8 | 35.3 | 123,474.3 | 43.5 | 29,411.5 | 31.3 |
| 1.2 Savings bonds | 1,953.4 | 0.7 | 6,085.3 | 2.1 | 4,104.9 | 210.1 |
| 1.3 Non-marketable TS | 13,525.8 | 5.1 | 11,300.1 | 4.0 | -2,225.7 | -16.5 |
| 2. Other domestic debt | 12,997.2 | 4.9 | 8,980.0 | 3.2 | -4,017.2 | -30.9 |
| **II. Foreign debt** | **120,835.2** | **45.3** | **98,909.1** | **34.8** | **-21,926.1** | **-18.1** |
| 1. Debt in the Treasury securities (TS) | 22,536.9 | 8.4 | 23,366.4 | 8.2 | 829.4 | 3.7 |
| 2. Debt in credits | 98,298.2 | 36.8 | 75,542.7 | 26.6 | -22,755.6 | - 23.1 |

**Table 9. The State Treasury debt according to resident (PLN mn at face value)**

| Item | XII 2000 | Structure XII 2000 | XII 2001 | Structure XII 2001 | Change XII 2001 – XII 2000 | |
|---|---|---|---|---|---|---|
| | PLN mn | % | PLN mn | % | PLN mn | % |
| **The State Treasury Debt** | **266,816.8** | **100.0** | **283,937.5** | **100.0** | **17,120.7** | **6.4** |
| **I. Domestic debt (to residents)** | **130,313.9** | **48.8** | **167,124.7** | **58.9** | **36,810.8** | **28.2** |
| 1. TS debt | 117,316.6 | 44.0 | 158,146.0 | 55.7 | 40,829.4 | 34.8 |
| 1.1 Marketable TS | 101,837.4 | 38.2 | 140,787.6 | 49.6 | 38,950.2 | 38.2 |
| - Treasury bills | 22,786.2 | 8.5 | 34,283.0 | 12.1 | 11,496.8 | 50.5 |
| - Treasury bonds issued on domestic market | 76,966.9 | 28.8 | 103,663.8 | 36.5 | 26,696.9 | 34.7 |
| - Treasury Bonds issued on foreign markets | 2,084.2 | 6.8 | 2,840.8 | 1.0 | 756.6 | 36.3 |
| 1.2 Savings bonds | 1,953.4 | 0.7 | 6,085.3 | 2.1 | 4,104.9 | 210.1 |
| 1.3 Non-marketable TS | 13,525.8 | 5.1 | 11,300.1 | 4.0 | -2,225.7 | -16.5 |
| 2. Other domestic debt | 12,997.2 | 4.9 | 8,978.7 | 3.2 | -4,018.6 | -30.9 |
| **II. Foreign debt (to non-resident)** | **136,503.0** | **51.2** | **116,812.8** | **41.1** | **-19,690.2** | **-14.1** |
| 1. Debt in TS | 38,204.7 | 14.3 | 41,268.7 | 14.5 | 3,064.0 | 8.0 |
| 1.1 Marketable TS | 38,204.7 | 14.3 | 41,268.7 | 14.5 | 3,064.0 | 8.0 |
| - Treasury bills | 656.1 | 0.2 | 932.6 | 0.3 | 276.5 | 42.1 |
| - Treasury bonds issued on domestic market | 17,095.9 | 6.4 | 19,810.5 | 7.0 | 2,714.6 | 15.9 |
| - Treasury bonds issued on foreign markets | 20,452.7 | 7.7 | 20,525.6 | 7.2 | 72.9 | 0.4 |
| 2. Debt in credits | 98,298.2 | 36.8 | 75,542.7 | 14.5 | -22,755.6 | -23.1 |
| 3. Other debt | 0.0 | 0.0 | 1.4 | 0.0 | 1.4 | - |

### 1.8.2. State Treasury debt to the Gross Domestic Product

The State Treasury debt in relation to GDP at the end of 2001, increased to 39.3% in comparison to 39.0% as of the end of 2000. The same level of increase occurred in the State Treasury debt enlarged by anticipated disbursements on sureties and guarantees granted by the State Treasury to Gross Domestic Product from 40.3% (end of 2000) to 40.6% (end of 2001).

**Table 10. State Treasury debt in years 1990 - 2001 according to face value and in relation to GDP***

| Item | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ST debt total (PLN bn) | 53.3 | 66.2 | 99.6 | 138.1 | 152.2 | 167.3 | 185.6 | 221.6 | 237.4 | 264.4 | 266.8 | 283.9 |
| In relation to GDP (%) | 95.1 | 81.8 | 86.7 | 88.7 | 68.0 | 54.3 | 47.9 | 46.9 | 42.9 | 43.0 | 39.0 | 39.3 |
| Domestic debt (PLN bn) | 7.0 | 13.0 | 25.9 | 40.1 | 55.9 | 66.2 | 79.6 | 104.1 | 121.2 | 134.7 | 146.0 | 185.0 |
| In relation to GDP (%) | 12.4 | 16.0 | 22.5 | 25.7 | 25.0 | 21.5 | 20.5 | 22.0 | 21.9 | 21.9 | 21.3 | 25.6 |
| Foreign debt (PLN bn) | 46.3 | 53.2 | 73.7 | 98.1 | 96.4 | 101.1 | 106.0 | 117.6 | 116.2 | 129.7 | 120.8 | 98.9 |
| In relation to GDP (%) | 82.7 | 65.7 | 64.1 | 63.0 | 43.0 | 32.8 | 27.3 | 24.9 | 21.0 | 21.1 | 17.6 | 13.7 |
| GDP (PLN bn) | 56.0 | 80.9 | 114.9 | 155.8 | 223.9 | 308.1 | 387.8 | 472.4 | 553.6 | 615.1 | 684.9 | 721.6 |

* GDP value is presented according to the Central Statistical Office methodology taking into consideration a "hidden economy".

**Table 11. State Treasury debt enlarged by anticipated disbursements on sureties and guarantees of the State Treasury, in face value and in relation to GDP**

| Item | 1999 | 2000 | 2001 |
|---|---|---|---|
| State Treasury debt enlarged by anticipated disbursements on sureties and guarantees of the State Treasury (PLN mn) | 272,532.1 | 276,202.6 | 293,274.1 |
| In relation to GDP (%) | 44.3 | 40.3 | 40.6 |

### 1.8.3. State Treasury Debt in 2001 - Key Issues

1) Increase of debt by PLN 17,120.7 mn with reference to the end of 2000 to the amount of PLN 283,937.5 mn;

2) Increase of debt to GDP ratio from 39.0% (end of 2000) to the level of 39.3% (end of 2001);

3) Considerable growth of domestic debt in non-banking sector by PLN 25,425.9 mn, i.e. by 41.3% in comparison to the end of 2000 to the level of PLN 86,972.2 mn;

4) Significant increase of debt in TS as a consequence of higher (almost by PLN 12 bn) state budget deficit as adopted in Budget Act for 2001, and with simultaneously lower (by some PLN 11.5 bn) than planned revenues from privatization; this situation influenced the debt structure – for example the debt in Treasury bills increased, instead of forecasted decrease;

5) Early repayment of Poland's debt to Brazil

In 2001 Poland signed the agreement with Brazil which provided for, with the consent of the Paris Club member countries, early repayment in November of a debt at face value of USD 3.32 bn for an amount of USD 2.46 bn (this debt was repaid for a 74% of its face value). The debt to Brazil should be paid off in incremental installments up to 2009 (the biggest payment should have fallen on 2008).

The means for this debt buy-out were from the foreign currency account of the Ministry of Finance (USD 0.32 bn) and, mainly, from purchase of the foreign currency from the National Bank of Poland (USD 2.14 bn). In exchange the central bank received USD denominated bonds (at face value of USD 2.14 bn) with floating-rate and maturity date of November 2003.

6) partial premature redemption of Brady bonds

In April 2001, Ministry of Finance executed the operation of partial premature buy-out of Brady bonds at face value of USD 289.5 mn;

7) new debt management instrument implementation

In November, 2001, Ministry of Finance introduced a new instrument debt management – so called switching auctions. Among the main objectives of the switching auctions are:

- Limitation of the refinancing risk,
- Increasing of benchmark bond issues,
- Closing of small marketable and non-marketable bonds as well as bond issues with little liquidity,
- Buy-out of the Treasury securities not appreciated by the market,
- Interest Rate risk management.

As an effect of the switching auctions bonds of total face value PLN 2,610.9 mn were written off. In their place the State Treasury issued securities totaled for PLN 2,527.6 mn of face value.

8) issue of the 5-year retail bonds.

### 1.8.4. Other Central Government Debt

Data regarding the central government sector, excluding the State Treasury[6] indicates the constant growth of these entities debt (from PLN 12,133.3 mn as of the end of 2000 to PLN 15,910.3 mn as of the end of 2001 – before consolidation). Simultaneously there was the increase of these units' share in total public finance sector debt (from 4.2% in 2000 to 5.1% in 2001). The comparability of this data is limited due to the fact that in June 2001 for the first time the data was obtained from all categories of entities within this sector.

In the period of December 2000 – December 2001 the highest debt among the government sector subjects with exclusion of the State Treasury showed Social Security Institution and funds managed by this agency. By the end of December 2001, the debt of these units attained the level of PLN 13,173.5 mn (excluding counter-claims of units in this sector – PLN 7,173.5 mn) against PLN 10,163 mn in December 2000. Increment of the debt resulted mainly from the increase of the liabilities of Social Security Fund to open pension funds (from PLN 3,593.0 mn in 2000 to PLN 5,469.1 mn as of the end of 2001). At the end of 2001 there was no reports on the Social Security Fund debt towards commercial banks.

Significant influence on the level of other government sector debt had commitments of the Healthcare Funds[7]. As of the end of December 2001, these amounted to PLN 1,052.8 mn (PLN 154.4 mn after consolidation), in comparison to PLN 1,143.0 mn as of the end of 2000 (PLN 218.5 mn after consolidation).

In the discussed period the debt of earmarked State funds being legal entities (Social Security Institution - SSI and the funds managed by this agency excluded) increased to the level of PLN 192.8 mn, and of the other legal entities established under other acts for performing of public tasks, with exclusion of enterprises, banks and commercial law companies attained an amount of PLN 386.8 mn (PLN 336.3 mn after consolidation).

Among the entities, from which the recordings on the debt were obtained for the first time in 2001, the biggest debt showed self-managed public healthcare establishments – PLN 476.0 mn (PLN 389.7 mn after consolidation). The debt of the research and development units was at the PLN 368.3 mn level (PLN 254.3 mn after consolidation), and that of the State academies and universities amounted to PLN 237.9 mn (after consolidation PLN 186.4 mn). Debt of the State cultural units and of Polish Academy of Science and of its organisational units attained together PLN 22.0 mn (PLN 15.9 mn after consolidation).

[6] Indebtedness before consolidation within public finance sector.
[7] Data on Healthcare Funds is available as from 2000.

Table 12. Other debt of the government sector in 2000 - 2001 (before consolidation)

| Item | XII 2000 | VI 2001 | XII 2001 | Change XII 2001 - XII 2000 | |
|---|---|---|---|---|---|
| | PLN mn | PLN mn | PLN mn | PLN mn | % |
| **Other government sector debt** | **12,133.3** | **14,202.0** | **15,910.3** | **3,777.0** | **31.1** |
| - SSI and funds managed by SSI | 10,163.0 | 11,262.9 | 13,173.5 | 3,010.5 | 29.6 |
| - Healthcare Funds | 1,143.0 | 1,025.1 | 1,052.8 | - 90.2 | - 7.9 |
| - The State earmarked funds being legal entities (SSI excluded) | 1.8 | 244.3 | 192.8 | 191.0 | 10,362.4 |
| - State academies and universities | N/A | 405.8 | 237.9 | 237.9 | - |
| - Research and development units | N/A | 372.0 | 368.6 | 368.6 | - |
| - Self-managed public healthcare establishments | - | 397.2 | 476.0 | 476.0 | - |
| - State cultural units | N/A | 5.1 | 5.5 | 5.5 | - |
| - Polish Academy of Science and its organisational units | N/A | 27.7 | 16.5 | 16.5 | - |
| - Other state legal entities established under separate laws | 825.4 | 461.9 | 386.8 | - 436.6 | -53.1 |

### 1.8.5. Local Government Debt

The debt of the local government is composed of local government units (LGU) debt and other debt of the local government sector. In 2001 for the first time there was available data on other local government units debt. This debt amounted to PLN 2,569.1 mn at the end of the 2001 (before consolidation) and after consolidation to a total of PLN 1,759.9 mn. The biggest debt in this item was shown by self-managed public healthcare establishments supervised by the LGU. As of the end of 2001 their debt amounted to PLN 2,432.6 mn, after consolidation PLN 1,683.6 mn.

At the end of 2001 the debt of LGU totaled PLN 12,266.4 mn (after consolidation PLN 9,008.8 mn), in comparison with PLN 9,377.1 mn as of the end of 2000. However, the debt of all government sector before consolidation amounted to PLN 14,835.5 mn (PLN 10,768.7 mn after consolidation). The comparability of this data is also limited due to the fact that the reports prior to 2001 did not include the other debt of the local government units.

Table 13. Local government debt in 2000 - 2001 (before consolidation)

| Item | XII 2000 | VI 2001 | XII 2001 | Change XII 2001 – XII 2000 | |
|---|---|---|---|---|---|
| | PLN mn | PLN mn | PLN mn | PLN mn | % |
| **Local government sector debt** | **9,377.1** | **11,191.1** | **14,835.5** | **5,458.4** | **58.2** |
| **I. Local goverment units debt** | **9,377.1** | **9,104.3** | **12,266.4** | **2,889.3** | **30.8** |
| 1. Domestic debt | 9,147.9 | 8,890.8 | 11,989.2 | 2,841.3 | 31.1 |
| 1.1. Debt in securities issued | 826.2 | 922.2 | 1,552.3 | 726.1 | 87.9 |
| 1.2. Debt in received credits and loans | 7,271.6 | 7,067.2 | 9,637.2 | 2,365.6 | 32.5 |
| 1.3. Other debt | 1,050.0 | 901.4 | 799.7 | - 250.3 | - 23.8 |
| 2. Foreign debt | 229.2 | 213.5 | 277.2 | 48.0 | 20.9 |
| 2.1. Debt in securities issued | 131.0 | 116.1 | 122.8 | - 8.2 | - 6.3 |
| 2.2. Debt in received credits and loans | 98.0 | 97.3 | 154.3 | 56.2 | 57.4 |
| 2.3. Other debt | 0.1 | 0.0 | 0.1 | 0.0 | - 44.7 |
| **II. Other local government sector debt** | **N/A** | **2,086.8** | **2,569.1** | **2,569.1** | **-** |
| 1. Earmarked funds being legal entities | N/A | 38.8 | 26.4 | 26.4 | - |
| 2. Self-managed public healthcare establishments | N/A | 1,881.7 | 2,432.6 | 2,432.6 | - |
| 3. Local government cultural establishments | N/A | 47.2 | 62.4 | 62.4 | - |
| 4. Local government legal entities established under separate laws | N/A | 119.1 | 47.7 | 47.7 | - |

### 1.8.6. National Public Debt to Gross Domestic Product

Relation of national public debt to GDP was 41.9% as of the end of December 2001 in comparison with 40.9% as of the end of 2000. At the same time the relation of national public debt including anticipated disbursements under sureties and guaranties granted by the public finance sector entities to GDP increased from 42.3% to 43.2% as of the end of 2001.

Table 14. National Public Debt in years 1999 - 2001

| Item | XII 1999 | XII 2000 | XII 2001 |
|---|---|---|---|
| National Public Debt (PLN mn) | 273,383.4 | 280,473.8 | 302,089.2 |
| In relation to GDP (%) | 44.4 | 40.9 | 41.9 |
| National Public Debt enlarged by anticipated disbursements on sureties and guaranties given by public finance entities (PLN mn) | 281,676.7 | 289,964.0 | 311,585.3 |
| In relation to GDP (%) | 45.8 | 42.3 | 43.2 |
| GDP (PLN mn) | 615,115.3 | 684,926.1 | 721,575.3 |

### 1.9. State Treasury Debt Servicing in 2001

Growth of the domestic as well as foreign debt between 1991 and 2001 and implementation of complex servicing of the indebtedness, entailed more than proportional increase of the pace of their costs growth. In connection with this, the State Treasury debt servicing costs very quickly became one of the most important items on the expenditure side of the state budget. Furthermore their systematic growth had a substantial influence on the budget deficits.

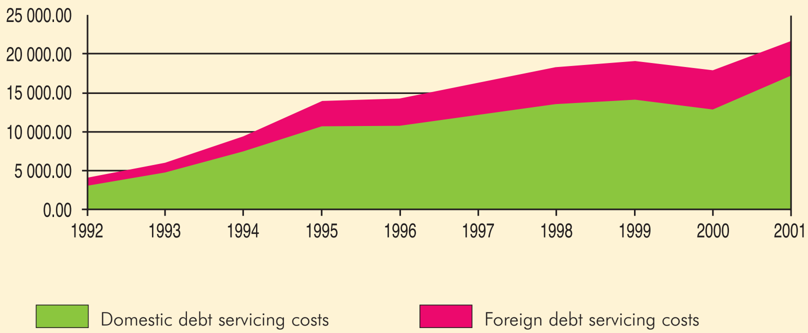
Till the end of the year 2000 the debt servicing costs (starting from 1993), were higher than budget deficits. It meant that in this very period the state budget showed a primary surplus. A primary surplus in the state budget means that when the expenditures on public debt servicing are not taken under the account, the expenditures in a given year are lower that budget incomes, and therefore the budget could be closed with a surplus.

The year 2001 was somewhat peculiar, first – the budget act was amended twice, and finally the budget deficit was planned at the level of PLN 32,979 mn[8]. In consequence the cost of debt servicing in that year came to a little over 2/3 of the planned deficit. Moreover, it was the first year when the State Treasury debt increased in relation to the GDP.

Costs of foreign debt had the dominant share in the State Treasury debt servicing costs, at the beginning of the '90s (see Chart No. 5). This trend has changed in 1992 onwards. The increase of domestic debt servicing costs and their high share in total debt servicing costs accompanied the process of making the domestic debt more marketable. Between the years 1995 and 1999 the share of domestic debt servicing costs in overall costs of the State Treasury debt service have oscillated between 77-79.3%, showing a slight increase. In that period the share of foreign debt servicing has fallen a little from 23% to 20.7%. In year 2000 in comparison with 1999 the share of foreign debt servicing costs in the total debt servicing increased to 23.8%. At the same time the share of the domestic debt servicing costs decreased to 76.2% of the overall State Treasury debt servicing costs.

[8] It meant the increase of the initial deficit amount by 61%

**Chart 5. The debt servicing costs according to domestic and foreign debts (PLN mn)**




At the end of 2001 the domestic debt service costs grew and constituted 4/5 of the total debt servicing costs.

The State Treasury debt servicing costs are the most important single item in the state budget, partly depending on market variables such as:

- Yields of the Treasury bills and money market deposit interest rates (for example LIBOR, WIBOR,etc.) – floating-rate Treasury securities.
- Market prices of the convertible currencies (so called foreign currency exchange rates) – all financial commitments in foreign currencies.

Because of the above, some costs are not known in advance and one cannot foresee the exact amount of the expenditures. Due to prudential considerations, the manager of the national public debt is forced to create reserves for unexpected changes of the foreign currency exchange rates as well as for interest rate changes on the money market. Situations in which the planned amount of expenditures is lower than the actual needed should be avoided. For this would lead to a budget act amendment and could imply that the public finance lacks stability.

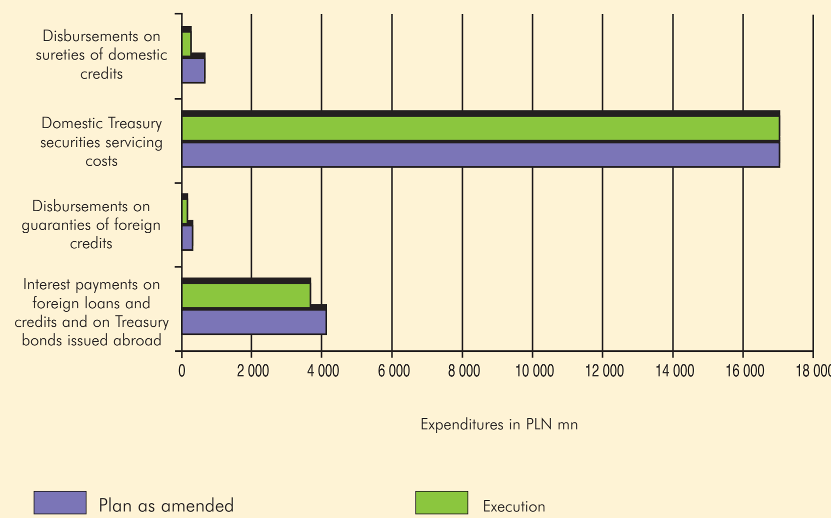
The need of maintaining reserves arises also from the need of an active approach to public debt management (see Chapter II). Every time when the market conditions are favorable enough for the issuer, he should have the means to conduct operations on the debt itself such as conversion of present liabilities into new ones (switching operations) or their premature redemption. Rigid expenditure level, assuming a small reserve margin, can effectively prevent these type of actions.

The total debt servicing costs in the year 2001 budget act were set on the level of PLN 21,746.15 mn (PLN 17,429.45 mn – domestic debt and PLN 4,316.70 mn – foreign debt). The actual amount of debt servicing costs which were executed in 2001 was lower by PLN 847.58 mn and came to PLN 20,898.57 mn. (see Chart 6).

The lower than assumed in budget act level of these expenditures execution was possible thanks to:

- Favorable exchange rates PLN/USD and PLN/EUR - (plan: 4.6143 PLN/USD and 4.3762 PLN/EUR, execution: 4.0939 PLN/USD and 3.6686 PLN/EUR).
- Favorable cross exchange rates of other currencies except of that of EUR to USD.
- Executing the interest payments from Treasury bonds issued on foreign markets and the debt towards Paris Club in January 2002 instead of in December 2001.
- Lower than assumed in plans level of interest rates and a favorable currency pool in 2001.
- Partial premature redemption of Brady bonds.
- Lower than planned use of EBOR (mainly) and EIB credits.
- Lower disbursements on guaranties and sureties of foreign and domestic credits.

**Chart 6. Plan and execution of the 2001 Budget Act as to debt service expenditures**



# CHAPTER II Debt Management Strategy

Because of the importance of public debt for the economy, the costs of its service and distant time horizon of drawn liabilities, the management of this debt demands an approach extending beyond the current budget year. Adoption of the strategy secures transparency of the issuer's goals and adopted actions to the investors, market analysts and politicians. It also shapes the issuer's credibility. In Poland adoption of the debt management strategy was a product of the following considerations:

- Public finance law commits Minister of Finance to prepare a three-year public finance sector debt management strategy,
- The level of debt in relation to GDP is one of the criteria of participation in European Monetary Union and also influences the credit rating of the country.

Considering broader, macroeconomic meaning of the management, the indicators characterizing the debt are ratios of the State debt and costs of its service to GDP. They are illustrating the importance of the debt and consequences of its service to the country's economy. Other important indicators are ratios of debt and costs of service to budget revenues and size of the primary surplus, that is budget result, costs of service excluded. Measures used in assessment of the influence of the debt on inflation and monetary developments (so called monetisation of the debt) are pertaining to the debt structure as to creditors groups (banks, other financial institutions sector, households, other).

In narrower meaning of debt management, an element of which is risk management, there are employed measures characterizing, among others, maturity structure, place of drawing the debt - domestic vs. foreign market, type of interest rate - fixed or floating (Table 15).

Table 15. Risks in debt management process

| Risk | Description | Measures |
|---|---|---|
| Market risk | Tied with market prices changes<br>a) Interest rate risk,<br>b) Foreign exchange risk.<br>Affects costs of debt service to be borne with domestic and foreign obligations. | a) – share of fixed-rate bonds in debt,<br>- duration – average time of changes of debt service cost corresponding to changes in interest rates,<br>b) foreign debt share. |
| Refinancing risk | Connected with the necessity of raising funds for redemption of current debt. | Debt maturity profile, average maturity |
| Liquidity risk | Lack of opportunity to finance current liabilities and expenses,<br>Lack of opportunity to sell assets because of insufficient market depth (too small value of the securities on the market or too small number of active investors). | 1) level of reserves,<br>2) a volume of bond issues, number of active market participants. |
| Credit risk | Risk of non-performing loan or lack of the financial contribution from the contract counterparty. | Deposits and protecting agreements. |
| Operational risk | Mistakes and errors,<br>Legal risk – changes of law in force,<br>Risk of disrupting activity. | Internal control systems, information protection. |

## 2.1. Objectives of the Debt Management Strategy for the year 2001

The basic aim in public debt management is to provide the necessary funds for the budget and to enable the execution of budget payments at lowest possible costs while maintaining rational level of various risks. Formulation of objectives is done in certain macroeconomic situations as well as in defined market conditions.

Public finance sector debt management in years 2001-2003 adopted along with Budget Act for the year 2001 was developed in the period when significant current account deficit threatened the financial stability of the State. One of the factors influencing such a situation was public finance sector deficit and of crucial importance the state budget deficit, in which one of the biggest items on the expenses side are the costs of debt service. They constituted (as measured in relation to GDP) a real burden to the predicted condition of the public finance in the forthcoming years.



With the assumption of fast economic growth, decrease of interest rates, reduction of public finance sector deficit and entry to the European Union the biggest burden of these costs was foreseen for the next 2-3 years, while the following years would bring its diminishing. Because of that reason it was justified to limit costs in 2001 – 2003 and move them to the forthcoming years. This aimed at more even distribution of public debt burden. That meant acknowledging the debt as one of the most important macroeconomic categories (the broader aspect of debt management) and the debt service costs minimization as the most important goal for a period of 2001-2003.

Beside the category of the debt service costs as a burden for public finance, two other cost categories were separated: the category of real cost in the period determined by the maturity of the longest instruments and the category of costs arising from maintaining the debt interest at the higher level than possible to obtain. Along these objectives, also other objectives were formulated , pertaining to:

- Limitation of the refinancing risk in the domestic and foreign markets,
- Limitation of the interest rate risk and the foreign exchange risk,
- Greater elasticity of the domestic debt through decrease of non-marketable liabilities share,
- Diminishing of the debt monetisation through the increase of the non-banking sector share in the domestic debt,
- Optimization of the foreign debt repayment profile for the years 2004-2009,
- Optimization of the State budget liquidity management.

Most of the above mentioned objectives were in accordance with the main aim because of the prevailing conditions – inverted yield curve, cash basis budget accounting (the discount borne at redemption), increase of the non-banking sector potential. It was thus possible to minimize the burden of the debt service to the public finance sector with simultaneous extending of the average domestic debt maturity (decrease of refinancing risk), to increase the share of fixed-rate instruments in domestic debt (lowering the interest rate risk) and to increase the domestic non-banking sector share (de-monetisation of the debt). The goals of debt service cost minimization and lowering foreign debt share occurred to be contradictory (lower costs of raising funds in the foreign markets with the exchange rates at expected level). Because of the risk of refinancing the debt in foreign currencies and exchange rate risk this trade-off was judged as a limitation for minimization of the debt service costs.

In the mid 2001 there was an important change of macroeconomic conditions both the current ones (slowdown of the economic growth, decrease of the inflation, fast growth of the budget deficit, decrease of the current account deficit) as well as forecasted for the forthcoming years (slow-down of the GDP dynamics, continuation of considerable budget deficit instead of its gradual limitation). As the consequence the important changes took place also in the financial market. The considerable fall of the yield of the short-term Treasury securities as an effect of the reduction of the central bank interest rates with slower fall of the medium- and long-term market rates (as a consequence of the increase of the investment risk) flattened the yield curve, making the short-and long-term costs similar.

Presented changes evoked the turn in approach to the shaping of the debt service costs in 2001 as well as in the future. Transferring these costs for future years' budgets (in the form of high discount), also with high budget deficit burden, proved to be useless and non-rational. Besides, such a policy would result in faster nominal debt growth, which would increase the risk of exceeding the first safety threshold (50%) of the debt/GDP ratio, provided in the Public Finance Act.

The above considerations made for changing the emphases in the area of minimization of the debt service costs in the course of the year (continued in the Public Finance Sector Debt Management Strategy for 2002-2004, prepared in 2001). The minimization of the costs within the horizons defined by the redemption terms of instruments of the longest maturity was set as decisive objective instead. Other objectives were practically not amended but they were re-arranged, though. Basic goals and supplementary objectives were singled out, the latter to be executed depending on the financial market conditions. These objectives are as follows:

**Basic objectives:**

- Minimization of the debt service costs understood as:
  - Minimization of the costs in time horizons defined by the redemption of the instruments with the longest maturity,
  - Minimization of the debt service burden for the public finance sector, what in practice means proceeding to such a distribution of the costs in time as to obtain such a situation that their relation to GDP was not exposed to great fluctuations in particular years,
  - Minimization of the debt service costs as an action aimed for elimination of reasons for persistence of the debt interest rates on the level higher than minimal obtainable on the market.
- Limitation of the foreign exchange risk and of the risk of refinancing in foreign currencies.
- Optimization of the State budget liquidity management.

**Supplementary objectives:**

- Limitation of the refinancing risk in domestic currency.
- Limitation of the interest rate risk.
- Increase in the debt structure elasticity.
- Diminishing of the debt monetisation.

## 2.2. Strategy Implementation - Tasks and Instruments

The most important tasks of the strategy arising from the objectives implementation were set as:

- Increase in the liquidity, effectiveness and transparency of the Treasury securities market.
- Implementation of the Treasury securities primary dealership system.
- Continuation of the works on resolving the problem of liabilities service in the period of peaks of redemptions in 2004 – 2009.

• Development of the State budget liquidity management system.

• Continuation of conversion of the non-marketable debt into marketable instruments.

• Further development of the retail instruments distribution system.

The objectives of the strategy are performed mainly through securities issued by the Minister of Finance and by various operations on the debt components. The selection of the proper instrument's design and of the issuance policy has decisive influence on the execution of prevailing part of objectives pertaining to the minimization of costs, lowering interest rate risk and refinancing risk as well as broadening of the investor base.

Offered range of the instruments is gradually extended – in 2001 a 5-year bond for retail investors was introduced (in recent years first issues of-10 year fixed-rate bonds and savings bonds took place). In April, 2002, the 20 year fixed-rate bonds were issued, as a consequence of developments in the financial market and the demand for such an instrument. Some adjustments in the bond characteristics are made, for instance the 3-year retail and savings bonds. Beside the standard debt instruments, the actions of the Minister of Finance can be supported by the use of derivatives, first of all interest rate and currency swaps. Such instruments may be used in risk management (for shaping the obligations' characteristics) as well as in budget's liquidity management.

The second group of the instruments of implementing the Strategy includes operations on the debt components. It pertains currently to the premature redemption of the liabilities with unfavorable characteristics (non-marketable bonds), switching operations on the securities before their maturity, restructuring different forms of debt other than Treasury securities, incurred or taken over by the State Treasury (planned issues for pension funds or earlier conversions of debt in NBP, healthcare units liabilities).

Besides widening of the range of the available instruments and operations, there were actions carried out to improve the liquidity and depth of the secondary market. Issuance policy aims at providing sufficient liquidity (which is reflected in the spread between bid and ask prices). It is conducted on new issues as well as on existing ones through the switching operations. Moreover, the process of implementing the Treasury securities dealers system, along with introducing Treasury securities secondary market electronic trading platform are in advanced stage.

Legal instruments and decision-making procedures are another form of instruments aiding the implementation of the strategy provisions. The first category refers mostly to the introduction of the legal solutions which improve the debt management efficiency (among others exclusion of the debt service costs from strictly limited expenses category), implementation of the optimization and simulation debt management methods, as well as implementation of integrated IT system supporting debt management. Moreover one of its elements are actions aimed at eliminating certain causes of persisting debt interest rates on a level higher that possible to obtain (the transaction costs, not sufficient transparency and security of the instruments trading).

The category of decision-taking procedures is pertaining to the defining of the decisions within debt management for attaining the desired characteristics of financing sources and issued instruments. There were also important internal and external conditions and other limitations. They were arising from formulated objectives (minimization of cost burden aimed at to even distribution of the relation of the costs to GDP), the level of borrowing needs of the State budget, acceptable level of risk as well as from developments in the financial markets (demand for the Treasury securities and development of the domestic financial market, the country's credibility expressed in credit ratings).

### 2.3. Strategy 2001 – Execution of Objectives and Assessment

In 2001 the conditions, under which the debt management Strategy was developed and then implemented, have changed. The Strategy was adequately amended and in consequence the objectives were also modified, as mentioned earlier. Changes in economic situation proved to be so significant that they evoked notable changes in debt level and in its relation to GDP in comparison to planned in 2000. Instead of expected decrease in 2001 there was an increase of the State Treasury debt to GDP ratio from 38.9% to 39.2%, and in the case of the national public debt from 40.9% to 41.9%. This was caused by:

• Slowing down of the of the economic growth from planned 4.5% to 1.1%,

• Increase of the budget deficit from initial amount of PLN 20.5 bn to PLN 29.1 bn in first June amendment of the budget and later to PLN 33.0 bn in second one in December (there was PLN 32.4 bn as performed),

• Lower than expected privatization revenues – PLN 6.5 bn instead of PLN 18.0 bn. planned.

Increase in the discussed relation is expected for the next years in forecasts of public finance sector performance (the State budget deficit at the level of ca 5% of GDP), as well as for all economy (the real GDP growth at some 1-4%). It means that forecasts made in 2000 should be changed considerably. The possibility to cross the security threshold of 50% and necessity to launch prudential procedures emerged as a real danger.

Despite these unfavorable conditions and trends it was possible to obtain good results in executing most Strategy objectives in 2001, with particular emphasis on the minimization of costs.

In the first half of the 2001 the dominant approach to the cost issue was the minimization of the cost burden to the public finance and, in consequence, limiting of costs for years 2001-2003. That was executed mainly through the mix of offered securities – 5-years bonds were dominant. As an effect of the change in macroeconomic situation and decisive cost category, the approach to cost of service was also modified, with view to minimize costs in the period of maturity of the longest securities. This was tied with adjustment of securities structure to current market developments. When yields of different Treasury securities were high, their sale was lower and inversely. Simultaneously in connection with the decrease in the short-term interest rates, implying lower current cost of debt service, and with increase in the budget deficit and lower than expected privatization proceeds the reserve sources of finance were enlarged. These were Treasury bills, floating-rate bonds and savings bonds. The increased sales of these instruments was possible due to the situation in 2000, when. the supply of floating-rate bonds was strongly limited and the government sector debt in Treasury bills was diminished.

Execution of the remaining objectives of the public debt management Strategy in 2001 was as follows:

**Limitation of the foreign exchange risk and the risk of refinancing in foreign currencies** – the share of foreign debt according to the place of issue in 2001 decreased from 45.3% to 34.7%. That was a result of the decrease in the debt in USD from USD 28.7 bn to USD 24.8 bn, appreciation of the PLN against USD (from 4.14 to 3.99) as well as increase in domestic debt by PLN 40.2 bn. Decrease in foreign debt by USD 3.9 bn was possible because of premature redemption of Brady bonds (USD 0.3 bn) and pre-payment of Brazilian debt (USD 3.6 bn). A positive tendency of growing share of the debt denominated in EUR (from 36% do 43%) in foreign debt was also observed. This will have a great importance when Poland joins the European Monetary Union, eliminating the exposure to foreign exchange risk in this part of foreign debt.

**Limitation of the refinancing risk in domestic currency** – the average maturity of marketable debt has fallen from 2.58 to 2.51 years. It was the effect of a growth in Treasury bills debt by PLN 11.8 bn, well balanced sale of 2-year and 5-year bonds (respectively PLN 15.0 bn and PLN 15.4 bn) and not large in comparison with latter sale of 10-year bonds (PLN 5.7 bn). These figures show that there was no reduction of refinancing risk, but small worsening of these relations. It was mainly caused by the unexpected increase in sale of short-term securities as a consequence of budget deficit growth and lower privatization proceeds.

On the other hand the parameters of debt maturity were improved by switching bond auctions initiated in November 2001 and operation of conversion bonds held by the NBP. These actions made for diminishing of the short-term debt in favor of securities with longer maturities.

**Limitation of the interest rate risk** – the share of the marketable fixed-rate bonds in domestic debt increased from 51.7% to 52.4%. Simultaneously there was a growth of Treasury bills' share from 16.1% to 19.0% and marketable floating-rate bonds from 12.8% to 14.0%. The greater indebtedness in Treasury bills was a result of the earlier mentioned factors. Greater share of floating-rate securities is an effect of issue of bonds intended for redemption of Brazilian debt. Another measure of interest rate risk – namely marketable securities duration was improved in 2001 from 1.69 to 1.76. Still, it is insufficient level when comparing it to the developed countries where it stands at 3-5 years.

**Greater flexibility of debt structure** – owing to the premature redemption of the Brazilian debt the non-marketable foreign debt was decreased by USD 3.6 bn.

Within the domestic debt there were further conversions of the State Treasury liabilities taken over from healthcare units and liabilities of the State Treasury deriving from the property lost by the trade unions and other social organizations as a consequence of introduction of martial law in 1981.

Moreover, the premature redemption of restructuring bonds A series was executed for a total of PLN 198 mn. In accordance with established timetable, the payment of the compensations for failed remuneration increase in the budgetary sphere is under way.

These actions in 2001 made for decrease of the non-marketable debt share in domestic debt from 18.2% to 11.5%.

**Decrease of the debt monetisation** – the share of the non-banking sector in domestic debt increased in 2001 from 42.2% to 45.9%. Taking into consideration exclusively the State Treasury securities in the possession of this sector, this relation was even better improved, from 34.3% to 41.6%. This was because of the growing investments of the domestic pension funds (increase by PLN 6.9 bn), insurance companies (PLN 10.2 bn), investment funds (PLN 4.0 bn) and of individual persons (PLN 6.8 bn).

**Optimization of the foreign debt repayment program for years 2004-2009** – premature redemption of the Brazilian debt significantly diminished the volume of redemptions in the period of the peak payments to the Paris Club, limiting thus the risk of their refinancing (Chart 7).

**Chart 7. Repayment of the foreign debt and bonds for NBP in 2002-2010**


The debt of face value of USD 3.32 bn was redeemed for 74% of that amount, that is for USD 2.46. In the effect the structure of the future redemptions of the foreign debt in years 2003-2009 was flattened from some USD 0.2 bn in 2002 to some USD 0.6 bn in 2008. The pre-payment was financed by funds from the currency account of the Ministry of Finance (USD 0.32 bn) and mainly by purchase of foreign currency from the NBP (USD 2.14 bn). In exchange for that the central bank received 2 year floating-rate bonds denominated in USD. The resolving of the problem of other payments would strongly depend on the political and economic situation of Poland (accession to European Union as well as to European Monetary Union).

Optimization of the State budget liquidity management – in November 2001 regular switch bond auctions were introduced. They decrease the borrowing needs of the budget earmarked for redemption of bonds. Other actions in 2001 were at the field of detailed planning and monitoring of the financial flows in the three month term and PLN and foreign currency deposits management.

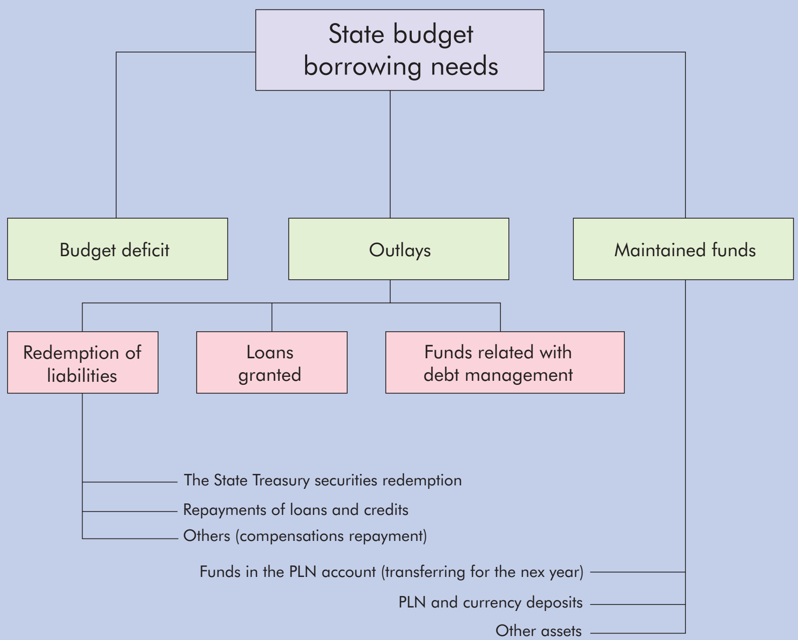
# CHAPTER III

## Financing borrowing needs of the state budget in 2001

### 3.1. Borrowing needs of the state budget

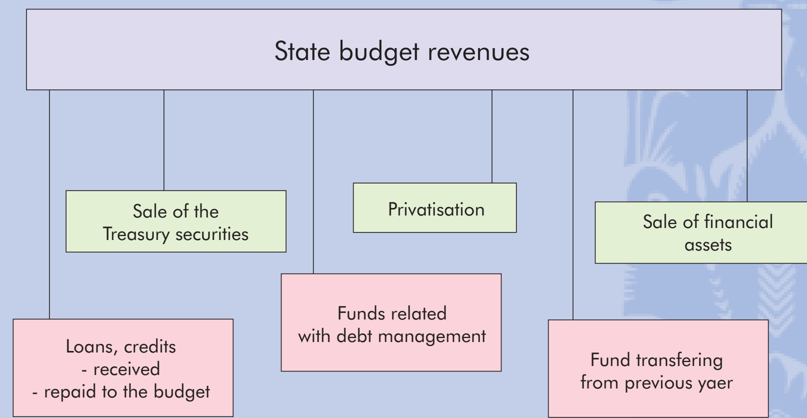
The state budget borrowing needs derive from the necessity of financing the following items (diagram 1).

**Diagram 1. State budget borrowing needs**




The source of these funds are revenues (diagram 2) and budget surplus in previous years. The balance of revenues and outlays is equal to the difference between expenditures and incomes (increased by the potential previous years' budget surplus). With budget deficit presence budget revenues are necessary for financing higher expenditures. However, they occur in case of budget surplus, as well. This can arise from the short term need of supporting the liquidity or from the necessity to repay liabilities (refinancing), if the amount of the generated surplus is not sufficient.

**Diagram 2. State budget revenues**




Revenues and outlays are generated both on the domestic and foreign markets. This creates many possibilities to shape the domestic and foreign balances of financing. Foreign revenues can be then exchanged into domestic currency, and be used for purpose of foreign repayments (refinancing) or deposited in the special currency account, from which later foreign debt is being serviced. Foreign outlays can also be covered by purchase of foreign currencies from the central bank's foreign reserves. At present, foreign funds are being deposited in the special currency account (since mid 2000). This made for stabilisation of the foreign currency market aimed at reducing the risk of severe PLN appreciation, especially in time of considerable inflow of foreign privatisation funds.



The most important item on the revenue side are the Treasury securities. The term revenues from Treasury securities means amounts received from their sale.

Besides issuance of Treasury securities the state budget can also draw loans and credits. Other revenues are repayments of loans granted by the State Treasury, inflows from sale of State Treasury's property (privatisation) and financial assets as well as funds coming from various debt management and budget liquidity management operations (swap and repo transactions).

Categories revenues/outlays also include so called funds transferring from one year to another. These are the funds deposited in the state budget current account at the end of the year for the purpose of financing borrowing needs at the beginning of the next year. It is an important element of the state budget liquidity management, which in course of the budget year occurs in the form of foreign currency and PLN deposits opened by the State budget in the central bank. The funds remaining in the foreign currency account at the end of year are also classified as transferring (currency) funds.

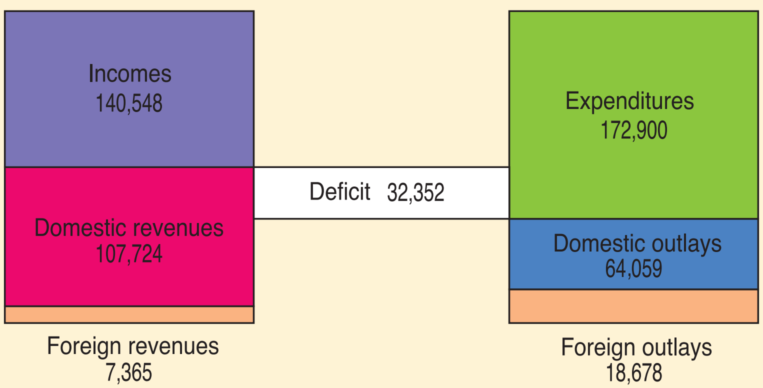
### 3.2. Financing borrowing needs of the state budget in 2001

The 2001 state Budget Act provided for the deficit ceiling of PLN 20,539 mn (incomes: PLN 161,065 mn, expenditures: PLN 181,604 mn). In July the first amendment to the Budget Act was made which lowered income projection and left expenditures unchanged. Deficit as planned was at PLN 29,139 mn. At the end of the year Budget Act was amended again. This time the income projection was left unchanged and the expenditures were increased. Deficit was to amount to PLN 32,979 mn. It means an increase from the initially planned level by 61%.

The actual State budget deficit as of the end of 2001 amounted to PLN 32,352 mn, i.e. 98% of the amount provided for in the second amendment to the Budget Act (Chart 8). This deficit was a result of incomes at PLN 140,548 mn (92% of the plan as amended) and expenditures at PLN 172,900 mn (93% of the annual plan as amended).

Deficit was financed from domestic sources. Moreover, the domestic revenues covered the negative foreign balance of PLN 11,312 mn. This balance contains also deposit (outlay) of PLN 902 mn in the foreign currency account. These funds come from eurobonds issued in December 2001. As a result, foreign outlays were in fact lower by this amount. The above operations are explained in the section describing foreign financing.

Chart 8. State budget balance and borrowing needs in 2001 (PLN mn)

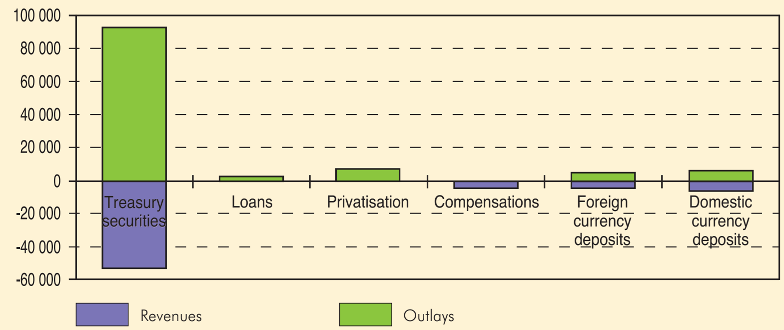



#### 3.2.1. Domestic financing

The balance of the domestic financing was in 2001 a result of revenues PLN 107,724 mn and outlays PLN 64,059 mn (PLN 64,961 mn including proceeds from the December eurobonds issue). The volume of the domestic borrowing needs was then more than three times bigger than the deficit itself.

Such a level of domestic borrowing needs derived to large extend from the balance of Treasury securities. This balance was a result of the revenues at PLN 87,213 mn and outlays at PLN 54,111 mn – the balance of PLN 37,612 mn. The other items of the domestic financing were not so significant (Chart 9). It means, that in 2001 the state budget borrowing needs were mainly financed by Treasury securities issues.

Chart 9. Revenues and outlays in the domestic financing in 2001 (PLN mn)




This balance in the Treasury securities was materially different from the year 2000, when the balance reached merely PLN 5,678 mn, as a result of record, so far, revenues from privatisation (PLN 26,746 mn).

In 2001 increased issuance of Treasury securities and in the consequence considerable increase in the domestic debt was arising from low privatisation revenues (PLN 6,490 mn) and necessity to finance the negative balance of foreign financing.

The privatisation revenues are characterised by the considerable irregularity and unpredictability. This makes it difficult to plan issuance of the Treasury securities and to manage the budget liquidity. The initial budget act and its first amendment provided for the revenues from the sale of the state property at PLN 18,000 mn. Although the second amendment lowered this target to PLN 10,140 mn, it was also missed and the privatisation revenues as of the end-year amounted only to PLN 6,490 mn - 64% of the plan as amended. Majority of these proceeds (79%) were in foreign currencies (USD and EUR). These funds were deposited in the currency account and were not used for financing the current borrowing needs (as of year-end they were treated as funds transferring for next year). Moreover, most of the privatisation proceeds were received in the fourth quarter of the year. As a result, a part of foreign currencies had to be purchased from the NBP.

The other factor which significantly influenced the Treasury securities balance was premature redemption of the Brazilian debt executed in November. The operation was financed from central bank's foreign reserves (USD 2,140 mn) and in exchange for the funds Minister of Finance issued USD denominated bonds for this amount (in PLN terms 8,702 mn). Broader description of this operation can be found in section pertaining to the foreign financing.

### 3.2.1.1. The Treasury securities

Synthetic data on sale and redemption of the Treasury securities are presented in Table 16. The Treasury bonds were the most important instrument for budget deficit financing. The balance of bonds financing borrowing needs (without non-marketable and bonds issued for redemption of the Brazilian debt) amounted to PLN 20,966 mn as a result of following bond issues balance:

- fixed-rate – positive PLN 21,730 mn, and 89% of revenues,
- floating-rate – negative PLN 764 mn, and 11% of revenues.

On the retail instruments market the financing balance amounted to PLN 1,879 mn (19% of revenues), and on the wholesale bond market to PLN 19,087 mn (81% of revenues).

In case of Treasury bills, their importance in financing increased in 2001– the yearly revenue value balance totalled at PLN 10,793 mn (as compared to negative balance of PLN 4,328 mn in 2000). The main reason for such a situation were lower than planned privatisation revenues. The bills financed the deficit and they were the tool for regulating the budget liquidity in the course of the year. The revenue value of bills sold in 2001 and to be redeemed in 2002 amounted to PLN 30.838 mn, and redemption of the bills from the previous year totalled PLN 20,045 mn (which resulted in the increase by PLN 10,793 mn). It means that for the purpose of liquidity management in 2001 there were sold and redeemed bills of total value of PLN 12,644 mn.

The segment of non-marketable bonds coexists with the segments of marketable and retail securities. These bonds at the moment are only serviced and redeemed (repayment of the principal and interest). In November 2001 there was also a premature redemption of restructuring bond series A for an amount of PLN 198 mn.

Annex to this Report contains more statistical data of the primary Treasury securities market.

**Table 16. Treasury securities issued on the domestic market for financing state budget borrowing needs (PLN mn)**

| Item | Revenues | Outlays | Balance |
|---|---|---|---|
| State Treasury securities | 91,723 | 54,111 | 37,612 |
| 1. Treasury bills | 43,482 | 32,690 | 10,793 |
| 2. Marketable bonds | 43,730 | 18,157 | 25,574 |
| - Zero-coupon bonds (OK) | 11,786 | 5,404 | 6,382 |
| - Five-year fixed-rate bonds (PS, OS) | 15,975 | 7,524 | 8,451 |
| - Ten-year fixed-rate bonds (DS) | 2,864 | 0 | 2,864 |
| - Ten-year floating-rate bonds (DZ) | 1,390 | 0 | 1,390 |
| - Three-year floating-rate bonds (TZ) | 2,662 | 5,229 | -2,567 |
| - Five-year fixed-rate retail bonds (SP) | 352 | 0 | 352 |
| - USD denominated bond (financing the Brazilian debt buy-out) | 8,702 | 0 | 8,702 |
| 3. Savings bonds | 4,510 | 416 | 4,094 |
| - Two-year fixed-rate bonds (DOS) | 4,083 | 401 | 3,681 |
| - Four-year indexed-linked bonds (COI) | 427 | 15 | 413 |
| 4. Non-marketable bonds | 0 | 2,848 | -2,848 |
| - USD denominated bond (1991 issue) | 0 | 1,817 | -1,817 |
| - Restructuring bonds | 0 | 957 | -957 |
| - Bonds issued to increase BGŻ S.A. bank equities | 0 | 74 | -74 |

### 3.2.1.2. Other items of the domestic financing

#### Revenues

Other items in the domestic financing which occurred in 2001 are repayments of the loans by Healthcare Funds (PLN 75 mn), Orbis S.A. (PLN 6 mn) and State Treasury Agricultural Property Agency (PLN 272 mn).

#### Outlays

2001 saw a continuation of compensation repayments for failure to increase remuneration in the budget sphere and the loss of some increases or bonuses to retirement or disability pensions. This operation started in March 2000 and generated for the state budget cost of PLN 2,469 mn in 2001. The average amount paid in the course of seven month was PLN 353 mn.

### 3.2.2. Foreign financing

Similarly as in 2000, the balance of foreign financing in 2001 was negative totalling PLN 11,312 mn (PLN 5,020 mn in 2000). It was a result of revenues at PLN 7,365 mn and outlays at PLN 18,678 mn. The above amounts of revenues and outlays are not an exact reflection of the flows connected with the foreign financing. They are inflated by the currency account operations as required by the budgetary accounting rules. Funds in the currency account (from sources other than privatisation) are booked as outlays when they are deposited and as revenue at the time of their utilisation. These operations are also affected by movements in PLN exchange rate, when exchange rate differences are generated. If such operations had not been included then the foreign balance would have been PLN 10,363 mn with revenues of PLN 6,051 mn and outlays of PLN 16,414 mn (the account balance was PLN 902 mn from the December bonds issue, the exchange rate differences amounted to PLN 47 mn). Table 17 presents the most important items of the foreign financing in 2001.

**Table 17. Foreign revenues and outlays in 2001 (PLN mn)**

| Item | Revenues | Outlays | Balance |
|---|---|---|---|
| Foreign financing | 7,365 | 18,678 | -11,312 |
| 1. State treasury securities on foreign market | 3,721 | 574 | 3,147 |
| - typical foreign bonds | 3,721 | 472 | 3,249 |
| - Polish Brady bonds | | 102 | -102 |
| 2. Early repayment of foreign liabilities | | 10,926 | -10,926 |
| - buy-out of Brady bonds | | 933 | - 933 |
| - buy-out of Brazilian debt | | 9,993 | -9,993 |
| 3. Foreign credits | 1,401 | 4,228 | -2,827 |
| - Paris Club | | 3,374 | -3,374 |
| - The World Bank | 584 | 602 | -17 |
| - European Investment Bank | 351 | 34 | 316 |
| - European Bank of Reconstruction and Development | | 15 | -15 |
| - Other | 466 | 203 | 262 |
| 4. Sale of collateral securities | 809 | | 809 |
| 5. Foreing currency account turnover | 1,314 | 2,264 | -950 |
| 6. Other | 121 | 686 | -565 |

The operation that had the biggest influence on the shape of foreign financing was early redemption of debt to Brazil executed in November. It was one time operation that resulted from the situation of the creditor country. The government of Poland obtained a consent for this operation from all Paris Club member countries.

Premature redemption was also performed on Brady bonds issued in 1994 as a result of London Club debt restructuring. The April buy-back of these securities for the amount of USD 232 mn (PLN 933 mn) lowered nominal value of foreign debt by USD 290 mn and it was a fourth operation of this kind. The previous operations were executed in 1997, 1998 and 2000 mostly on the bonds which were collateralised with the US zero-coupon bonds. Premature redemption of these Brady bonds meant releasing from the deposit a portion of collateral making it available to the Minister of Finance. In January 2001 a considerable part of the released bonds (USD 1,554 mn at face value) was sold, and then converted into PLN. As a result proceeds of USD 439 mn (PLN 1,800 mn) were generated, of which USD 242 mn (PLN 991 mn) of the accrued principal was booked as income and USD 197 mn (PLN 809 mn) of initial principal supported revenues. The above division of the generated funds is arising from the budgetary accounting rules and practically meant additional income and financing of a fraction of borrowing needs (revenues).

Effect of these operations on the budget debt is described in the section on implementation of the debt management strategy goals. Another aspect of these actions is their favourable reception on the international financial markets. It translates into assigned ratings and pricing of new securities issues.

In 2001 one new foreign bond was issued. The issue was executed in two tiers – in February and December. The 10 year securities mature in February 2011. The revenue amounts obtained from the sale were, respectively, EUR 742 mn (PLN 2,817 mn) and EUR 250 mn (PLN 904 mn). Proceeds from the first tier were in part (EUR 492 mn – PLN 1,868 mn) exchanged into PLN in the central bank, and in part (EUR 250 mn – PLN 949 mn) deposited in the currency account and later used for April redemption of the Brady bonds. The portion exchanged into PLN, similarly as proceeds from the sale of collateral bonds were used for financing of state budget borrowing needs, lowering the demand for funds from the domestic market. The negative aspect of such actions is their influence on the monetary policy, as they increase money supply and generate inflationary impulse.

Apart from presented operations of premature debt redemption, in 2001 regular repayments on the maturing debt (foreign credits) were performed. It included payments to Paris Club as well as other creditors (World Bank, European Investment Bank, European Bank for Reconstruction and Development, others). Moreover, there was a redemption of the principal instalments of Brady bonds and full redemption of the 5-year bond issued in 1996 denominated in DEM.

### 3.2.3. State budget liquidity management – local and foreign currency funds

The liquidity management provides for raising funds to secure financing borrowing needs, while taking into account the following conditions:

• uneven distribution of incomes and expenditures both in yearly profile (lower incomes in the first half of the year) as well as in monthly profile (higher expenditures with lower incomes in the first and second decade of the month and the opposite in third decade),

• limitations as to the Treasury securities (uneven demand profile in course of the year),

• low predictability of the privatisation proceeds,

• implementation of the goals of the public debt management strategy.

The above conditions enforce the state budget to accumulate periodical financial surpluses in form of deposits (PLN and foreign currency ones). Another instrument of liquidity management is issuance of short-term Treasury bills.

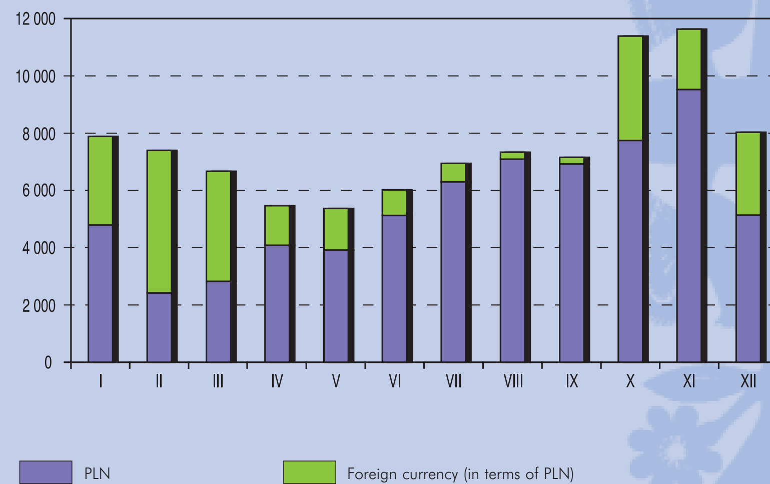
Maintaining cash in the form of deposits or reserves is connected with costs of servicing the securities from issue of which these funds were raised. At the same time the state budget receives incomes from interest on these deposits in central bank.

Despite unfavourable developments and high deficit, the liquidity situation of the state budget was generally satisfactory. It was greatly influenced by relatively high level of transferring funds from previous year 2000 – PLN 5,595 mn and PLN 3,562 mn (USD 859 mn). The balance of the PLN deposits at the end of each month, except for the first quarter was usually maintained at the safe level, enabling to finance borrowing needs which are usually higher in the first two decades of each month. Certain difficulties and necessity of issuance of short-term Treasury bills (2 week) were experienced in June only. In the second half of the year the balance of the deposits in PLN was at constant growth. That was attributed to uncertainty to further development of the budget standing and to the necessity of accumulation of adequately large funds for 2002. Finally, they were at PLN 5.2 bn and they were the element of financing the borrowing needs in the first quarter of the 2002.

Apart from PLN deposits, foreign currency deposits were made as well. Their source were mainly foreign currency funds from 2000, foreign currency proceeds from privatisation (respectively USD 689 mn and USD 611 mn) and proceeds from issues of the Eurobonds (EUR 750 mn and EUR 250 mn). In result the balance of these foreign currency funds in the course of the year was not adequately high. In September high payments had to be covered with foreign currency purchased from the central bank. Finally the revenues from privatisation of Telekomunikacja Polska S.A. in October supplemented this short-fall. As a result the balance of the foreign currency funds at the end of the year was USD 715 mn (PLN 2,849 mn). The balance of deposits in PLN and in foreign currencies is presented on Chart 10.

Since November switching auctions became an important instrument for budget liquidity management. They are helpful in limiting the refinancing risk through the switch of bonds with short maturity (usually up to one year) into longer securities. The switch auctions were executed for securities with maturities in February and April 2002.

Chart 10. The balances of PLN and foreign currency funds as of the end of particular months in 2001 (PLN mn)



## SUMMARY

*The changes that took place in the Polish economy in 2001 did not make the tasks of the public debt management easier. A slowdown of the economic growth rate from the planned 4.5% to a mere 1.1%, lower than expected revenues from privatization (PLN 6.5 billion instead of PLN 18 billion) and the increase of the state budget deficit from original amount of PLN 20.5 billion to PLN 33.0 billion in the second, December amendment to the Budget Act, resulted with a serious change of the debt level and its relation to the GDP in comparison to the figures assumed in 2000. Instead of an expected drop in 2001, the ratio of the State Treasury debt to the GDP increased from 38.9% to 39.3%, similar increase from 40.9% to 41.9% occurred in the case of national public debt. In these circumstances it was necessary to change the issuance policy as well as to re-group the targets determined in the Public Finance Sector Debt Management Strategy, including the turn in approach to the basic objective of the public debt management, i.e. the minimization of the debt service costs. The approach to shaping of the servicing costs in 2001 as well as in the future years was also modified.*

*As it appears, the coming years 2002 and 2003 shall not be advantageous for the manager of the national public debt due to the drop in dynamics of the GDP, significant level of the state budget deficit instead of its gradual reduction and the growth of State Treasury debt servicing costs. All of that comes for the time preceding accumulation of repayment of the foreign debt in the years 2004 - 2008.*

*Despite those disadvantageous circumstances and trends, positive effects have been reached in 2001 as far as the performance of most strategic targets is concerned, through:*

*• successive broadening of the range of offered instruments - the issue of a five-year fixed-rate retail bond. Moreover, the issue of twenty-year fixed-rate bond in April 2002, was possible thanks to market participants consultations conducted during the year 2001,*

*• modification of existing instruments, three-year floating-rate and savings bonds may serve as examples here,*

*• operations on the debt itself, like among others:*

*- early redemption of liabilities with disadvantageous characteristics (non-marketable debt), early repayment of Polish debt to Brazil which is a spectacular example of such an operation. It was only possible in agreement with all members of the Paris Club. Moreover, the Ministry of Finance managed to effect early redemption of a part of the Polish Brady Bonds in April 2001.*

*- switching operations on bonds just before their maturity into other securities with longer maturity, thanks to which the redemption stack-up of the first quarter of 2002 was relieved. This period in each year is particularly difficult for the state budget,*

*- restructuring different forms of debt (other than Treasury securities), incurred or taken over by the State Treasury - i.e. further conversion of the healthcare units liabilities as well as commitments towards the trade unions.*

*Apart from development of the already available instruments and operations some actions aiming at improving of the liquidity and the deepening of the secondary market were also undertaken:*

*• necessary assumptions, organization and legal framework was worked out to launch the primary dealership system for Treasury securities. Rich experience of the National Bank of Poland was used here. As a result of those actions in April 2002 a contest for the primary dealers candidates has started and, at*

*the same time, a secondary market electronic Treasury securities trading platform was implemented;*

*• nine series of Treasury Bonds traded on the secondary market have the face value of over PLN five billion. This is one of the conditions deciding about the liquidity of bonds. Consequently, especially since October 2000 the Ministry of Finance has been increasing the number of bonds issued within one series, attempting to create real „benchmark" issues. That kind of issuance policy should contribute to liquidity increase of the bond market and, consequently, lowering of premiums paid due to the lack of liquidity, which would reduce costs of the Treasury securities issued;*

*• the number of bond series newly introduced on the market was reduced to, in case of five-year PS bonds, two series instead of three per year and to one series of ten-year bonds within a two-year period;*

*• it was agreed upon with the National Depositary of Securities (NDS) to implement a policy of reducing transaction settlement fees, which at present constitute one of important barriers for the development of a liquid and transparent secondary market for the Treasury securities;*

*• multi-session settlement of transactions was introduced in the NDS allowing several transaction settlements during one market day, some transactions can be cleared and settled on the same day (the so-called T+0 term).*

*Despite of the above achievements, a number of strategic targets of the debt management determined in the Strategy need further intensive activity. They are the following:*

*• continuation of activities aimed at the elaboration of a foreign debt refinancing concept for the period of peak payments to the Paris Club in years 2004-2008;*

*• continuation of the Ministry of Finance policy aimed at creating a liquid, transparent and modern Treasury securities market, including primary dealership system for Treasury securities and of the electronic system of TS trading (the electronic trading platform),*

*• implementation of a new state budget liquidity management system covering among others: the extension of the planning horizon and monitoring improvement, creation of adequate technical and organization structure as well as the widening of the spectrum of debt management instruments,*

*• continuation of converting the non-marketable debt into marketable instruments,*

*• further development of retail instrument sales system,*

*• building of progress in the methodology of debt management - through, among others, implementation of information technology system for the debt management.*

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