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**Reform, Stabilization Policies,
and Economic Adjustment in Poland**

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**REFORM, STABILIZATION POLICIES,
AND ECONOMIC ADJUSTMENT IN POLAND**

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(Contents)

Acknowledgements	
Summary	i-iv
1. Introduction	1
2. Course of the Polish Economic Reform	5
2.1 Crisis and reform	5
2.2 Beginning of the process	9
2.3 Changes in the planning system	18
2.4 Institutional transformations	29
2.5 Effects of the <i>first stage</i>	32
2.6 <i>Second stage</i> of economic reform	39
2.7 External implications	50
3. Reform of economic system: some general comments	55
3.1 Lessons from historical experience	55
3.2 Market and central planning	58
3.3 Control and real spheres of the economy	65
3.4 Inflationary constraints	67
4. Structural transformations in the eighties	73
4.1 Trend of inertness	73
4.2 Crisis and structural adjustment	78
5. Priorities and constraints of economic policy in the process of economic changes	84
5.1 External debt	84
5.2 External and internal equilibrium: dilemmas and proposals	92
6. <i>Shortageflation</i> dilemma and its implications for economic stabilization and adjustment	100
6.1 Price distortions	100
6.2 Trade-off: price inflation <i>versus</i> shortage	102
6.3 Uninstitutionalized public debt	105
7. Prospects for economic development: alternative scenarios	109
7.1 Continuation or acceleration?	109
7.2 Economics and politics of acceleration	113
8. Conclusions	118
List of Tables	122
List of Figures	123
Bibliography	124

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Summary

The mechanism and dynamics of the recent economic developments in Poland determine the mechanism and the implementation methods for adjustment programmes and stabilization policies. *The syndrome of crisis phenomena in Poland is composed of three planes: systemic, structural and political.* One must also view the *adjustment and stabilization processes* in the very same planes and configuration, as only such an integrated approach to the problem promises a solution.

The attempt to introduce a *radical, breakthrough systemic reform* had been made in Poland in the years 1981-82 and is now continued in the second stage of economic reform. Monetization, introduction of market relations, an enhanced role of money and of the banking system, elimination of centralized planning in physical units and the gradual introduction of indicative strategic planning, reinforcement of grass-roots, company level initiative, promotion of worker's self-management, are the principal features of systemic changes now underway. These attempts must be accompanied by progress in the *democratization of political relations*, as there is a feedback between the latter and economic reform.

The second major drive is directed at *overhauling the legacy of a proinflationary, crisis-prone and uncompetitive economic structure*. Progress achieved in the eighties is thus far inadequate. The Polish economy has a poor export capacity, is heavily dependent on imports and is excessively material and energy intensive. The end of this decade is witnessing new attempts aiming at changes in the structure of investment, designed to produce a more export-oriented production structure and one capable of balancing the domestic consumer market.

Systemic and structural action must be backed up by appropriate *economic policies*. However, the traditional instruments of market stabilization cannot therefore be fully utilized, as they sometimes backfire and they must take account of the specificity of the centrally planned economy, enmeshed in very deep domestic and external disequilibrium.

Stabilization policies in Poland face two fundamental dilemmas. The first involves *competition between two tasks - prompt restoration of equilibrium in the current account of payments and the restoration of internal equilibrium*. It seems to be clear that domestic balancing should be given priority, as it is the key to successful systemic adjustment, on the one hand, and it offers better changes to eventually pay back foreign debts, on the other.

The second, so-called *shortageflation dilemma*, is connected with the specificity of the economy of shortage. It

concerns the choice between the scale of price (open) and repressed inflation. The efficient implementation of stabilizing and adjustment measures, as well as the needs of long-term external adaptation, require that *priority in this trade-off be given to the balancing of the domestic market*, otherwise the assumptions of the systemic reform will not be enforceable. The *shortageflation* syndrome in the case of reformed socialist economies seems to be *analogous cost of the long-run adjustment process* to the syndrome of *stagflation* in the developed capitalistic economies in the seventies and early eighties.

The World Bank and the International Monetary Fund opt for measures designed to quickly restore equilibrium in the current account of payments, even at the expense of a further deterioration of living standards in Poland and of falling real wages. This position is quite understandable if one considers the interests represented by these organizations. It is equally obvious that the Polish government can pursue only such stabilization and adjustment policies which can safeguard the precarious social and political equilibrium. Generalizing, one may say that *the fine art of stabilization policies and adjustment programmes in all the integrally interconnected planes, i.e. systemic, structural and political, must consist in striking the balance between economic necessity and political practicability.*

All the solutions presented in this study lead to two most likely scenarios for future developments in Poland. One

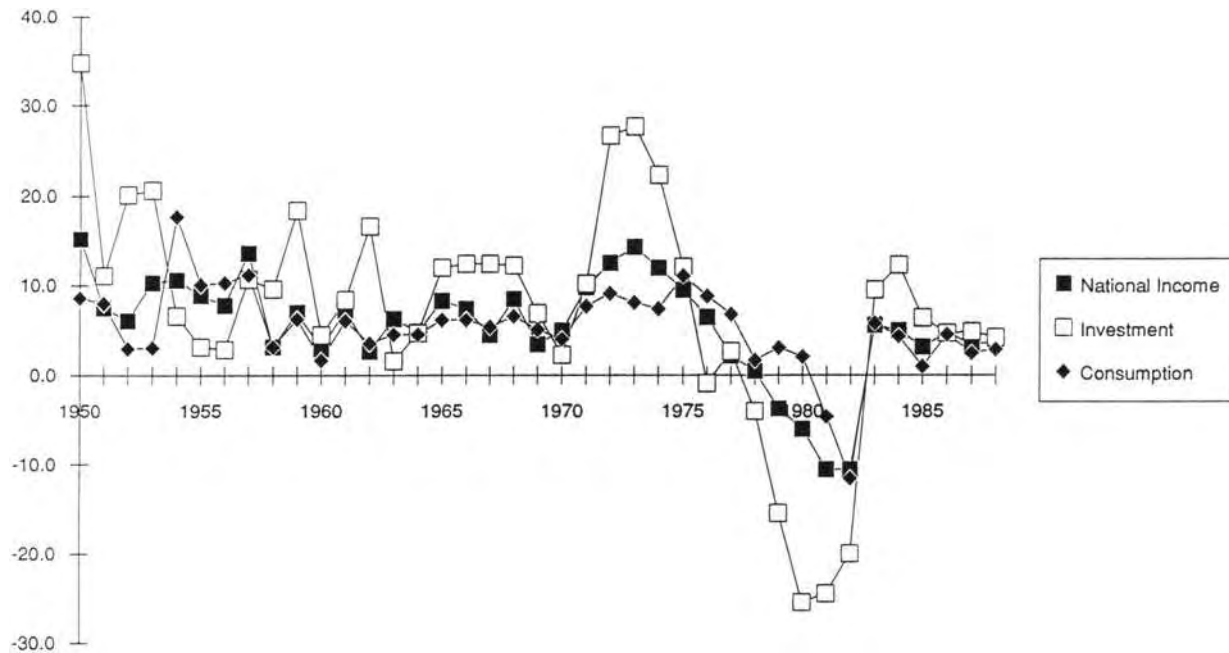
is a scenario of *continuation*, which comes down to the preservation of the hitherto character and pace of the processes analysed here, with only minor alterations. The alternative scenario would be one of an *acceleration of stabilizing and adjustment processes*. There are many premises suggesting that the alternative scenario is becoming increasingly probable. This is also connected with a particular political climate, which has quite an impact on the efficiency of measures implemented in the economy.

1. INTRODUCTION

Polish economy has been going through a visible crisis in the last decade or so. It has been reflected in such phenomena as low growth rate, relatively low (compared with earlier periods) investment rate, stagnant consumption (Figure 1), permanent domestic disequilibrium, ever increasing inflation rate, low propensity for technological and organizational innovations, low flexibility of the production capacities, poor competitiveness in international markets, increasing foreign debt, etc. The crisis did not spare the area of social and political relations. The feedback between economic, social and political relations is obvious. On one hand, economic processes determine political relations and, on the other, the sphere of politics reacts, bearing on the national economy, its performance, efficiency and growth rate.

Crisis phenomena and the adjustment processes which gradually lead to their overcoming, should be considered in at least three aspects. First, we are faced with a deep crisis in the operation of the national economy. It is in this sense that we shall speak of the *systemic crisis*. Second, one can clearly observe a *crisis of the prevailing economic structures*. This will be referred to as the *structural crisis*. Third, crisis phenomena have had a very strong impact on economic policy. Thus, we also have a *policy crisis*, meaning that the ways in which the policies have responded to the social and economic challenges, were inadequate.

FIGURE 1. Economic Growth in Poland (1950-1988)



Source: Rocznik Statystyczny, (Statistical Yearbook), Warszawa: GUS, variou. issues.

In other words, in analysing economic processes in Poland in the 70s and 80s, one must view three spheres: systemic, structural and political. What is more, this methodological premise must be applied not only to the analysis of primary and secondary crisis sources, but also to the interpretation of crisis mechanisms and for outlining the ways and measures of counteraction. Hence, *speaking about the stabilization and adjustment processes and prospects for development in the Polish economy, one must also see three inherently interrelated spheres: systemic, structural and political.* Systemic reforms initiated in Poland since 1981-1982 - are connected with the first of these three areas; programmes aimed at structural transformations - with the second and lastly - policy change and political reforms - with the third.

It is only against such a background that one can correctly evaluate the course of processes occurring in the control (systemic) sphere and in the economy (structural or real sphere), also in the aspect of economic policies enforced by the state. It is also in this aspect that a look at the assumptions and results achieved by various stabilization programmes worked out in the eighties should prove rather interesting.

The present study focuses on the eighties, as the period when the crisis was most marked and also countervailing stabilization and adjustment measures were best visible. In many cases, however, it was impossible not to reach back to the seventies, where the roots of the developments of eighties

are to be found. On some occasions an even further retrospection proved necessary.

The framework thus drawn for the empirical and theoretical analysis predetermines the approach to the problem and its presentation. A brief description of crisis phenomena in Poland is followed by deliberations concerning the feedbacks between economic system, structure of the national economy and economic policy, insofar as they are relevant to crisis sources and to overcoming this phenomena. Next comes a discussion of measures aimed at stabilization of the national economy and the process of its medium and long term adjustment - in the systemic, structural and policy spheres. Radical economic reform must be given a special meaning in this context, bearing in mind its determinants and barriers observed thus far in its implementation. It is only against such a background that one can speculate on general future prospects, concerning both further developments in the economy and the pace and directions of structural and political transformations. In the final section of the paper certain alternative scenarios of further developments in Polish economy are presented.

2. COURSE OF THE POLISH ECONOMIC REFORM

2.1 Crisis and reform

If economic reform is to be understood as a process of radical, qualitative and irreversible changes in the operation of the national economy, then it will always be a lengthy and complex process, in which different stages can be distinguished. That is also the case of the Polish reform of the eighties.

The need for systemic reform in Poland has been obvious for many years already. There have been several such attempts, but none were successful. Reformatory efforts of the 1956-1958 period and the so-called WOG (Large Production Units) reform of 1972-1973 were notable amongst these failures. Though these two reformatory drives differed in their objectives, neither had assumed such far-reaching changes as the reform initiated in the eighties. The expanse of the latter is due, among other things, to the need for measures much more radical than ever before. This necessity comes mostly from the unprecedented seriousness and widespread character of the crisis which hit the Polish economy, especially in the years 1979-1982.

The crisis (which I understand here as economic recession featuring an absolute decline in the production level) was amongst the deepest peacetime recessions to occur in the contemporary world. Distributed net national income (NNI) per capita in 1982 had fallen to 72.5% of the 1978 level, which was the last year of growth before the onset of the crisis.

Investment and consumption fell to, respectively to 55.0% and 88.7% of their 1978 levels. Recession embraced practically the entire economy and only its seriousness differed from sector to sector.

These figures alone are enough to illustrate the *typical reactions of the planned economy to perturbations in economic growth*. These reactions usually consist in attempts to stabilize the economy through a centrally imposed reduction in investment outlays, paralleled by a shift in their structure in favour of consumer industries, those producing agricultural means of production and of the social infrastructure and services. These areas tended to be the most neglected in the previous periods (Kolodko 1986b). This time, however, the economic collapse and disequilibrium were so dramatic, that these 'conventional' stabilizing instruments failed to bring the desired effects. The plunge continued.

The wave of strikes which hit Poland in the summer of 1980, can be understood only when we look upon it as a protest of consumers dissatisfied with living conditions, of workers contesting working conditions and poor management, and lastly - of citizens unsatisfied about the way they are governed. These comments appear indispensable, since these three factors have strongly borne upon the assumptions and course of reform thus far, as well as on the accompanying supportive (or obstructive) institutional and political reforms.

This character and seriousness of the Polish crisis could not have been without impact on the course of discussions concerning economic reform and later - on its blueprint. Experience provided by the earlier failures, on the one hand, and by misconceived stabilization programmes,¹ on the other, brought radical reform to the order of the day. Discussions in 1980 and 1981 opposed two conflicting views. The first suggested that forceful, radical stabilizing and reformatory action be postponed until 'better times', that is until some basic equilibrium is restored and until the economy recovers its capacity for economic growth. Thus, this view assumed that the erstwhile system, combined with some changes in economic policy, could assure the implementation of these preliminary conditions.

The opponents advocated the immediate need for systemic reform, justly advancing that one could not expect fundamental changes for the better, nor the permanent elimination of destabilizing phenomena and crisis sources to be achieved through policies, which, combined with the prevailing systemic solutions, had brought the crisis in the first place. This second view eventually came to prevail, largely due to the reformatory movement within the Polish United Workers' Party and to the Solidarity trade union. One cannot omit here the

¹ The so-called *economic manoeuvre* of 1976 constitutes the best example of a fiasco of a *stabilization programme* (although this expression was not common in the Polish economic jargon at the time). It called for major cutbacks in imports and investment outlays, and a shift in favour of export maximization and an increased output of consumer goods, as well as agricultural means of production. These, however, were merely attempts to modify economic policy without reaching to deeper - systemic - determinants of cumulating crisis sources. This is why such a stabilization programme could not have produced the effects it was proclaimed to be aimed at.

role of economic circles on the subsequent fate of reforms, which have been long involved in discussions on the principles of the new economic system.

Discussions over the blueprint of systemic reform and over changes which it would extort with regard to economic policy and structural transformations, devoted much attention to the problems of economic disequilibrium. Disequilibrium was ever more serious between 1980 and 1981. At the end of 1981 Poland actually arrived at what might be called a destruction of the domestic market, while the pace of repressed inflation brought a state sometimes referred to as *barbarian inflation* (Kolodko 1987a). This was reflected in the degeneration of economic and financial mechanisms to a point where the national economy has become practically unmanageable.

Despite the risks involved in the introduction of numerous elements of the market mechanism into such an utterly unbalanced economy, the view that a market-oriented systemic reform, supported by appropriate policy, should establish some durable premises for the balancing of the economy, had come to prevail. And not only with regard to consumer products, but also to the materials procurement market, capital goods market (though calling it a market might be an overstatement) and foreign trade. It is under such circumstances that the package of measures combined in the draft of economic reform (Kierunki 1981) has been elaborated and adopted.

A fundamental change in political determinants in the process of systemic reform came about in 1981, when the authorities imposed *martial law*. The authorities saw it as putting an end to a wave of anarchy and the *progressing breakdown of the entire national economy and of the state itself*. Martial law, on the one hand, did solve some problems, and, on the other, did create others. With regard to the economy, it at least achieved a certain degree of calm, putting a check on the escalation of strikes. This created some premises for the introduction of certain inevitable measures with regard to prices, without which economic reform would have made no sense at all.

2.2 Beginning of the process

Although several important modifications have been brought to the system of the economy's operation already in 1981 (among other things, they concerned a relaxation of earlier financial restrictions on small enterprises), it is generally assumed that the Polish economic reform had been launched in early 1982. It was then that the whole package of measures aimed at the systemic reform and economic stabilization was introduced. The package can be said to have had a three-plane structure. The first included a set of Parliament acts providing the legal framework and guarantees for economic reform. The second concerned plans and economic programmes adopted several months later, which, this time, were clearly aimed at short-term stabilization and medium-term adjustment. The third plane was made up of current economic

policy decisions made within the framework outlined by the two former. These decisions, however, sometimes already at the very beginning, relaxed certain constraints imposed by the two first planes.

It must be emphasized that the legal regulations introducing economic reform were conferred the highest possible rank, i.e. they were parliamentary acts. This is important in view of some sad experiences connected with the transitional nature of many regulations introduced under momentary political pressure. This time, it was the highest legislative body, which was supposed to guarantee the durability of these institutional and legal solutions. This no doubt represented some progress as compared with the past, though not even this can provide a total proof guaranty of the durability of the regulations which have been adopted.

Foremost in the package of reformatory acts are the laws on the state firm and on workers' self-management (adopted still in September 1981) and those on socioeconomic planning, prices and on banking (adopted along with some other laws in the end of February 1982, that is already under martial law) (Ustawa 1982a, Ustawa 1982b, Ustawa 1982c). These five legal acts provide the institutional cornerstone, a 'Constitution' of the Polish economic reform, as it were.

The market orientation of the economic and financial mechanism, coexisting with non-directive, predominantly strategic, central planning, was the foremost feature of the

economic system created within the above legislative framework. *Bureaucratic regulation, typical of the earlier periods, was to be shortly superseded partly by market regulation and partly by indicative macroeconomic planning.*

Such a model must be accompanied by *enterprises autonomy* with regard to economic activity. This autonomy is to be reflected in their managers' and staff's right to make the decisions on investment, supply sources, production and sales structure, profit distribution and foreign operations. Central intervention into enterprise management has been restricted to exceptions stipulated in the legal acts.

The *self-management* of company staff (first of all - the workers) is the second 'constitutional' feature of the new economic model. It is to be reflected in company staff's right to influence the fundamental decisions concerning profit distribution (within the framework of the existing system and regulations). This self-management also applies to the right to participate in the making of firms' strategic decisions, especially with regard to investment, lasting cooperative arrangements, specialization in export production, etc. The concept of self-management should be perceived not so much in the light of the criterion of economic performance, but rather in the social context. Self-management is to be, among other things, a means of curtailing the earlier omnipotence of the bureaucracy and of the party apparatus and, on the other hand, an attempt to increase workers' involvement in company

affairs, to implement *real socialization* of the ownership of the means of production.

Lastly, under the assumptions of the Polish reform, *self-financing* is to be its third main feature. This time, the point is to observe budget constraints, meaning that a firm can spend on its various goals only as much as it can generate from its economic operations. Naturally, this implies recourse to bank credits in the long term, as well as credit remissions or state subventions when justified. The general line of this systemic principle, however, is to harden the budget constraints in order to extort better economic performance from the firms sector.

Naturally, what I am presenting here is only the outline of the system referred to as the 'triple S'². Its day-to-day operation involves many clashes, contradictions and shortcomings. They are derived not only from the current economic, social and political environment, within which the system has to operate (e.g. limited autonomy resulting from the lack of self-financing in the face of state subventions, which in turn, are the result of distortions in price levels and structure and of the bureaucratic interventions), but also from the *imperfect theoretical clarity* of this concept of socialist economy. The main doubt, which must be mentioned here, although we shall not get involved in the details, is *the concept of the coexistence of the market mechanism and*

² In the Polish language, all these terms (autonomy, self-management and self-financing) start with an 'S'.

self-management. There is already quite an extensive literature treating on the possible coexistence of these two solutions (see e.g. Kierunki 1981, Nasilowski 1981, Lukaszewicz 1982), but convincing theoretical proof and practical corroborating evidence are still missing.³

Experience accumulated over the seven years of the Polish economic reform does not yet authorize too far-reaching conclusions with this respect. On the one hand, Poland has so far been unable to create the kind of conditions for the full operation of *self-management* which are stipulated in the legal acts cited above and, on the other, there is no market mechanism currently operating in the Polish economy, but merely some of its elements. Hence, the question about the full compatibility of the three 'S's (economic autonomy, workers' *self-management* and *self-financing*) remains open. This question is actually closely related to that about the compatibility of market and planned economic regulation.⁴

³ If one tried invoking Yugoslav experiences in this respect, they could have hardly be seen as tempting. See, among others, Vanek 1970, Horvat 1972 and Mencinger 1987.

⁴ It is in a similar context that Gey and Kosta (1987, p.8) have expressed the view that:

There are three more questions which are crucial for a transition of an economic system:

- *Is a dual system bedded in a coexistence of contrary elements (plan/market, public/private ownership, etc.) at all viable, and if so, to what extent?*
- *Is a reform feasible, or to what degree could it be feasible, if extra-systemic factors such as inherited structures, growth patterns, etc. are unfavourable?*
- *Is a market-oriented reform promising if the change-over is realized gradually, or should the transition be carried out in one step ('package deal')?*

The system of prices is essential for the performance of any national economy. Economic reform in Poland brought about important changes in this area, at least in comparison with the earlier periods. These changes can appear obvious, looking from the viewpoint of pricing reforms made earlier in Hungary or Yugoslavia, are quite inadequate, if one takes market economy standards as the benchmark.

Initially (in February 1982) *three price categories were introduced. These were state, negotiable and regulated prices.* The first were essentially a leftover of the old system, the last group constituted a harbinger of the new, while the middle group corresponded to some extent to the transitional nature of the solutions now implemented and to the specificity of the economy of shortage. State prices are applicable to staple consumer goods (initially, in 1982, slightly in excess of 50% of the value of total supply, then less and less, though there have been temporary increases in this share) and to the means of production, which were essential for production costs. The list of these prices is drawn up by the Parliament on an annual basis, while a competent ministry is responsible for setting their levels. Before that, it was done by the Price Office and since 1985 - by the Ministry of Finance, which carried out government policies with regard to prices.

Given the nature of the goods to which these state prices are applicable, it is obvious that in most cases they are subsidized by the state budget (with some exceptions as liquid

fuels, etc.). These subventions have only insignificantly fallen in the years 1983-1988, but were rather seriously curtailed following the price reform introduced in early 1982.

Prices for agricultural products are ruled by the so-called *productive and redistributive* formula. It is to ensure, on the one hand, the profitability of agricultural production and, on the other, an adequate income level for rural populations, so that it would remain in certain desirable proportions in comparison with the average incomes of the non-agricultural population.⁵ Naturally, state prices embrace - like for supplies for the industry and consumer goods - only those agricultural products, which are essential for production costs and for the cost of living.

It must be further said that the relevant law stipulates that prices for industrial supplies (raw materials, semi-manufactured products) must be correlated with world market prices. Technically it is done by calculating the so-called *transaction prices*, which, at a given exchange rate, reflect current market prices in domestic currency.

It has been further assumed, and this provision remains in force still today, that the exchange rate should be set at a level which would ensure the profitability of 80% of all exports. Thus, prices for industrial supplies should be changed when there are major fluctuations in the world market

⁵ For example, price decisions in force since July 1988 were aimed to fix this ratio at the level of 92%.

or when the exchange rate changes⁶ (which, given the current situation in Poland, can mean only devaluation).

The second group of prices - so-called *negotiable prices* - are shaped depending on market supply and demand relations. Their name - *negotiable* - in opposition to *free prices*,⁷ puts the emphasis on their negotiation between buyers and sellers. Actually, these prices are neither equilibrium prices nor negotiable. The former stems from the fact that producers are frequently satisfied with a predetermined profit margin⁸ and do not seek to raise the prices to the level designated by the existing demand, wishing to retain a certain latitude of freedom. This desirable margin of freedom offers the opportunity to increase the price whenever input costs rise (be it for a shift in the exchange rate, increased interest rate, a rise in the prices of industrial supplies, higher wages or taxes, etc.). Thus, a firm never has to face the demand ceiling, can remain within the scope of soft budget constraints and feel comfortably safe. Now, negotiable prices

⁶ During the first six months of 1988, the exchange rate actually did ensure the profitability of some 80% of exports, to both convertible and inconvertible currency areas. The 80% threshold is connected with the desire to continue agricultural exports, though it is unprofitable in most cases. For all its drawbacks, such a policy of a *submarginal* exchange rate does bring certain positive results.

⁷ Prices referred to as *free* in China and Hungary have exactly the same character. For various reasons (including periodical bureaucratic restrictions or political pressure) these prices actually tend to remain below the equilibrium level. See, among others, Török 1988 on Hungarian experiences and Zhang Yuyan 1988 for China.

⁸ It is worth mentioning here that some firms still come under public opinion and political pressure to restrict price increase, viewed as 'unjustified' or 'unfair' even when they are derived from prevailing market conditions. Thus, there is the still dominant approach according to which price increases need 'justification' in growing costs, rather than market signals in the form of growing (or even stable, but unsatisfied) demand.

are not really negotiable due to producers' monopolistic position, typical of the economy of shortage, and the corresponding, exceedingly weak position of the buyers (or consumers).

For all their shortcomings, negotiable prices are far better in the aspect of the performance of the economic and financial mechanism. This is why the scope of their applicability increases in line with advances made in economic reform. Their current share in the value of consumer goods is slightly in excess of 60%. The growth of this share, however, is not so much due to the limitation of the applicability of state prices, as to the gradual elimination of the third category, i.e. of the so-called *regulated prices*. The share of the latter in the value of the supply of consumer goods fell from about 10% in 1982, to some 2% in 1988. This price category came under heavy criticism ever since it was introduced in 1982, as it was definitely deleterious for economic efficiency. It enabled producers to include all costs, whether justified or not, in the price. Regulated prices are set on the basis of *actual* production costs plus a fixed margin (so-called *cost-plus formula*). Given deep disequilibrium, these prices are accepted in the market. There is no incentive whatsoever to cut down production costs. The desire to check inflation was the only - and rather illusive, as practice shows - rationale for the introduction of this price category. Curbing inflation, however, cannot be achieved by pegging prices and we shall revert to that later on.

2.3 Changes in the planning system

Parallel to the price system outlined above, new regulations have been adopted with regard to the steering of the macroeconomic processes in the medium and long term. The *Law on Socioeconomic Planning* (Ustawa 1982a) was devoted precisely to these issues and, interestingly enough, was viewed by the community of Polish economists as the best in the whole reform package, which was probably why it aroused least controversies. The law stressed the major market-oriented shift in the system of economic control and the long-postulated abandonment of command-type management.

The law on planning officially approved the market orientation of the Polish economic reform. Planning was to be mostly indicative and concentrated on strategic goals, while the coordination of current economic activities was to be left to market regulation. Areas where direct, administrative instruments can be applied were few and clearly defined. The law also introduced the institution of government orders placed with autonomous companies.

The assumption was that such orders should be given to the highest bidders and the material distribution system should foster this form. In view of important supply constraints, government orders were quite often a guarantee of foreign exchange, scarce materials, etc., indispensable in

production.⁹ It is also this aspect that led to the failure of the concept of government orders as a new planning instrument, designed to shape the structure of output by non-administrative means. Soon enough, practice proved that 'everything was important and urgent'. Hence, the list of government orders grew ever longer, the parallel *operational programmes*¹⁰ ever richer, to the point where this instrument was no longer able to bring the desired structural effects. These drawbacks - and not only with regard to material distribution - were passed on from the areas which benefited from government orders to the economy at large.

The attempt at far-reaching *socialization of planning* was the second main feature of the new planning system, after abandonment of directive-type methods. This problem has a broader and not only economic dimension, as it is connected with crisis sources, its course and nature. Just as the issue of workers' self-management, the socialization of planning is connected with measures designated to *truly socialize property*, this time - on the macroeconomic scale.

⁹ The problem of material distribution has not been solved thus far. Still in 1987, some 35% of the basic raw materials and other production inputs remained under centralized, administrative rationing, even though according to the original assumptions of the reform this was to become a thing of the past by 1985.

¹⁰ *Operational programmes* were more of a stabilizing instrument than one of systemic changes, but they should be also perceived in the context of experiences with a new system of socioeconomic planning, under which they were intended to achieve concrete structural results in the short term. The achievement of these results was to be supported by preferential supplies, tax cuts, wage benefits and foreign exchange preferences. There is no doubt that privileged access to scarce supplies was the most powerful element of operational programmes, under the conditions of the Polish crisis of the early eighties. They frequently let production continue, where it would have otherwise stalled for the lack of inputs.

The socialization of the process of long-range macroeconomic planning is reflected, among other things, in the fact that the planning authority (the Planning Commission of the Council of Ministers) must submit *alternative variants of long-term plans* to the Parliament and to the general public. This procedure was twice put into practice thus far: when the 1983-1985 plan was prepared and during the elaboration of the 1986-1990 plan. The idea of presenting alternative plan options comes down to the government's duty to submit different socioeconomic development scenarios to the general public. These scenarios must clearly show their costs and the social groups which will benefit most from each variant.

Technically speaking, the elaboration of a long-term plan under these requirements consists in the presentation of at least two variants. Depending on the outcome of public debate, the government submits to the Parliament the conclusions drawn from these discussions and - on this already somewhat *socialized* basis - it proposes the adoption of one of the variants for the purposes of further planning work. Once the plan draft is ready, it is transmitted to the Parliament, which votes the final shape of the long-term plan. This procedure is no doubt more painstaking than before, but it at least offers the chance to include some additional aspects.

First, the planning body must draw up *alternative development policy scenarios*. This alone provides some

intellectual exercise, in-depth preliminary studies, comparative analyses, various demographic, economic, technological, financial and other forecasts.

Second, *the population and the groups which make it up have more opportunities to voice their economic interests.* This plane makes it easier for politicians, and for the population itself, to perceive and realize the constraints and controversies. This is a fundamental change. The high-handed and bureaucratized procedure whereby the hierarchy of economic and social goals was determined, was replaced by a mechanism of social consultations and negotiations. True enough, this mechanism still has many deficiencies and imperfections. This eventually leads to a political solution with regard to conflicting interests, opposed during the negotiations. In the initial stage of economic reform, this change has probably had a greater political than economic meaning.

The basic dilemma in the discussion on the variants of the three-year plan concerned the choice of one of the proposed variants of the growth rate. As it is usually done on such occasions, three variants had been proposed : optimistic, pessimistic and moderate (*Warianty* 1982). They differed with regard to the NNI growth assumed for the 1983-1985 period: respectively 11%, 16% and 18%. Eventually, the moderate variant was chosen, having been recognised as the most realistic. It served as the basis for the preparation of the entire three-year plan and its supplemental stabilization programmes. We must add that the actual NNI growth between

1983 and 1985 was 15.7%, which was very close to what had been assumed in the intermediate variant.

Another important point in the social consultations was to establish social preference with regard to the pace and methods to be adopted in solving food and housing problems. There were also numerous controversies over the growth rate of collective and individual consumption. Unfortunately, many methodological mistakes had been committed with this respect. They were due to confusion over the notions of *individual consumption* and *consumption financed from personal incomes*, on the one hand, and *collective consumption* and *consumption financed from social consumption funds*, on the other (Pohorille 1983). The outcome was such that the planning authority had failed to unequivocally establish social preferences (if it is possible at all) with regard to either of the issues (priority for housing or food and the hierarchy of the various forms of consumption). Eventually, the three-year plan assumed basically equal growth rates for outlays on the food economy and housing¹¹ and gave a certain priority to consumption financed with personal incomes (as well as to individual consumption), assuming it would grow at a rate slightly higher than overall consumption.

¹¹ These variants produced three different conceptions concerning the distribution of investment outlays. These were: the so-called *productive* sub-variant (assuming a 30% share of the food economy and 25% share of housing in total investment outlays), the *social* sub-variant (respectively 28% and 30%) and the *housing* sub-variant (respectively 24% and 35%). See *Warianty* 1982, p.110.

This new approach to long-term planning in Poland, launched in 1983, should be perceived in two aspects. First, I had pointed out the fundamental systemic changes connected with the modified status and methods of planning in the regulation of economic processes. Second, however, *the long-term plan in socialist economy remains one of the foremost instruments designed to steer economic growth*. It is, therefore, in this dual light that we should see the National Socioeconomic Plans for the years 1983-1985 and 1986-1990.

So, fervent discussions that took place in Poland in the 1980-1981 period gave rise to a programme designed to overcome the crisis. It underwent many changes and modifications. It was a typical (if one can call anything 'typical' in this context) stabilization programme, intended to halt the further slide into disequilibrium, on the one hand, and to curb inflation, on the other. The implementation of the essential elements of this programme started in early 1982 and were pursued in 1983-1985. They found their reflection in the three-year plan and in other parallel stabilization programmes. What I have in mind here, is the so-called *Savings Programme* and the *Government Programme for Counteracting Inflation* (Programme 1983). The latter owes its creation largely to the discussion on the variants of the long-term plan, since the need to consider different scenarios of inflationary processes and their possible implications for the stabilization of the national economy were frequently raised in these debates.

It is in this sense that the savings and anti-inflationary programmes were to be essential complements of the three-year plan to which they were subordinated. However, they failed to achieve their goals, because - among other things - being secondary and complementary by their very nature, they could not have changed the macroeconomic proportions (mainly vis-à-vis the investment structure) assumed in the superior three-year plan. And the latter actually retained the preferences for the replication of the prevailing economic structure. There were areas where this plan provided for some desirable changes, but it lacked adequate support from solutions implemented at that time in the framework of economic reform. Thus, we can see once again the strength of the ties between the systemic sphere, economic structure and economic policy.

Summing up this part of our deliberations, we may say that in the years 1982-1983 Poland had taken up a very ambitious - given the expanse and seriousness of the crisis - challenge of stabilizing and adjustment measures. They consisted in radical (though still insufficient) systemic changes (*economic reform*) and in attempts designed to initiate desirable *structural transformations*, which was what the 1983-1985¹² plan was intended for. This package of measures was to be significantly different from that in the previous periods

¹² This was the second three-year plan in Poland. The first covered the years 1947-1949 and dealt mostly with postwar reconstruction. This time, the choice of a three-year planning horizon resulted from the desire to keep in line with the planning cycle in other Comecon countries and, to some extent, from the conviction that a three-year period would be enough to stabilize the economy.

and which was enforced in a wholly different political environment, both in comparison with the seventies and with the period between mid-1980 until December 1981.

It may now seem naive, but it was generally assumed in 1982 that three years should be enough to introduce economic reform (its 'critical mass' *sufficient to bring qualitative changes which can ensure the irreversibility of the process*). The resistance of that which was to be changed, however, proved much stronger than anticipated. The successful implementation of the above stabilization package hinged upon a major change with regard to economic disequilibrium, especially in the consumer market. This is why shock therapy in the form of a central price operation was applied early in 1982.

Indeed, this has been a shock for the population. The average price level doubled practically overnight and with regard to many staple consumer products this rise was even higher (see Table 1). Though savings deposits were automatically compensated by an additional - despite the regular interest rate - 20% rise in their value,¹³ *the real value of households monetary assets suffered a major decline.*

¹³ The amount of this compensation remained frozen for the next three years in the form of special savings certificates bearing a 15% p.a. interest.

Table 1: RATE OF INFLATION IN POLAND (1980-1987)

Indices	1980	1981	1982	1983	1984	1985	1986	1987	1980-87 (Average)	1987 (1979=100)
Consumer goods (total)	9.4	21.2	100.8	22.1	15.0	15.1	17.7	25.7	28.4	636.6
of which:										
Commodities	9.6	22.1	106.8	21.0	14.7	14.0	17.5	24.4	28.8	640.0
Services	8.2	15.3	62.9	31.5	17.2	22.6	19.4	33.9	26.4	613.9
Food	12.8	22.5	136.3	11.9	16.8	14.9	14.6	22.0	31.5	685.6
Alcoholic Beverages	5.7	47.6	97.9	42.5	5.8	3.9	17.3	28.2	31.1	727.3
Non-Food	8.5	13.1	85.4	22.5	16.1	16.7	20.1	25.5	26.0	569.2

Source: *Rocznik Statystyczny, (Statistical Yearbook)*,
Warszawa: GUS, various issues. Own calculation.

The rationale behind the price reform, which resulted in an approximately 25% fall in average real wages,¹⁴ (Table 2) was to *dramatically curtail domestic demand*, which was necessary to initiate the elements of the new economic mechanisms connected with the market-type allocation of a part of the means of production and with the incentive system aimed at enterprises and their workers.

This attempt was only partly successful. *Equilibrium was not achieved*, even though consumption had suffered a dramatic fall (owing mostly to falling production, rather than to price increases). The situation deteriorated even further in the second half of 1982, following 'soft' policies on the part of the government, which relaxed financial constraints imposed on the companies by economic reform and the stabilization policy. That year saw average nominal wages rise by 12% percentage points *above* the original assumptions. *It no longer was a fully centrally planned economy, but it had even less in common with the market economy* (Pysz 1987). This state persists still today.

¹⁴ Average real wages fell in 1982 by as much as 24.9% but consumption over that period fell only by a 'mere' 12.3% (see *Maly Rocznik Statystyczny 1988*, (*Statistical Pocketbook 1988*), Warszawa: GUS; p.65,114). This phenomenon has a simple explanation, given deep market disequilibrium which accompanied these processes. We must add, that the actual decline in real households consumption was even lower, given the buffering effect of the earlier accumulated 'consumption capital' and households' increased activity in production and services (also within the *shadow economy*), and due to increasing incoming foreign transfers (Pohorille 1982).

Table 2: REAL INCOME OF HOUSEHOLD SECTOR (1980-1987)

Rate of growth (in %)	1980	1981	1982	1983	1984	1985	1986	1987	1980-87 Average
Average wages in the socialized sector	3.6	5.0	24.7	1.9	1.2	3.8	2.6	-3.7	-1.3
Social money benefits	5.7	13.0	19.2	-2.3	2.1	-1.2	8.2	4.0	6.1
Incomes of the non- socialized sector	1.9	31.6	-19.8	-9.3	-5.3	3.3	1.8	-3.3	0.1
Total real incomes	3.1	8.3	-18.5	0.4	3.0	6.8	2.5	0.6	0.8

Source: *Rocznik Statystyczny, (Statistical Yearbook)*, Warszawa: GUS, various issues; National Bank of Poland. Own calculations.

2.4 Institutional transformations

The above presentation of the basic elements of the new financial and economic mechanism is, of course, far from being exhaustive. There were important changes in many other areas of the economic system and of the state's economic policy. This is particularly true of the financial sector. The banking system gained its independence from the Ministry of Finance and the president of the central bank is nominated by the Parliament. It is also the Parliament that decides on the directions and instruments of monetary policies. Far-reaching changes can be observed with regard to company taxation, including wage funds. This, however, has not yet led to any significant decline in the tax burden imposed on the companies, nor to desirable stabilization. Also, it failed to bring wage increases under control.¹⁵ Decentralization is probably among the most important changes that took place with regard to the financing of investment projects. The central allocation of investment funds amounted to a mere 20% in the 1987-1988 period.

Important transformations have been also introduced in the *institutional sphere*, with regard to both the central and intermediate levels. What merits special emphasis here is the elimination of the so-called *enterprises' unions*, which were

¹⁵ Under the economic reform a system of progressive companies' wage fund taxation (so-called PFAZ, i.e. the State Fund for Professional Activization) has been used. The system, however, is not efficient enough and it has been assumed in the blueprint of the programme of the second stage of economic reform, that the new system of taxation imposed on personal incomes will be introduced in the future.

an additional intermediate link. The latter grouped various companies, on administrative principles, usually in the form of vertical integration. Thus, they were specific *socialist monopolies*, whose power was further enhanced by the lack of any domestic or foreign competition.

The economic reform brought about the liquidation of such monopolistic structures. Moreover, opportunities were created for companies to group themselves in the so-called *voluntary associations*. What had not been taken into account, despite many warnings to the effect from the economists, was that this solution involved the danger of the resurrection of the monopolization of production and commerce, so detrimental to economic performance. Soon enough, there was available evidence to prove that the cloak of 'voluntary' was used to organize monopolistic structures, in which autonomous companies were happy to participate fearing potential competition and also, as a matter of habit. Eventually, many former unions were replaced with associations, which did not differ much in economic terms.

On the other hand, legal regulations provide a certain latitude of freedom, under which central economic authorities can set up *compulsory associations*. Companies designated by the authorities must join. This offers the opportunity to use various methods to pressure companies and leads to the revival of certain old monopolistic structures under a new facade or to the creation of new monopolies. This process is continuously underway.

Speaking of important institutional changes we must also point to the overhaul of the central state and economic administration, initiated along with economic reform. Among other things, it found its reflection in the elimination of a number of branch ministries (especially those dealing with industry) paralleled by an enhancement of the role of the so-called functional ministries (Finance, Foreign Trade, Labour, Wages and Social Affairs, and the National Bank of Poland).

Constitutional guarantees of durability offered to private farming must be also counted amongst the most important changes. What must be stressed, is that private farming is far more important in Poland than in other socialist countries, since private farmers hold 76.5% of agricultural land and provide some 69.1% of all commodity agricultural output (employing 22.5 of total labour).

The legal recognition of the equal economic status of all forms of ownership in the economy: state (about 80% of 1987 NNI) and private (nearly 20%), has also had a fundamental meaning. Naturally, this time the point is to establish stable conditions - especially with regard to licensing, to the supply system and taxation - for the operation and development of the private sector, as well as for the elimination of bureaucracy and real socialization of the cooperative sector, which did not differ much from the state sector under the traditional system of command management.

I have above pointed to what I believe to be the essential elements of economic reform and to fundamental changes in the options and instruments of economic policy, which were introduced as a result of the economic and sociopolitical crisis. Their aim was not merely to achieve short-term stabilization, but also to initiate more durable changes and to create a mechanism capable of providing long-range structural changes. The latter will be discussed in greater detail later on. A question which seems worthwhile here is: *What are the concrete effects of these measures and what new challenges have they created for the economic system and policy in the period to come?*

2.5 Effects of the first stage

Changes with regard to control over the national economy were deep. There is no doubt that *budget constraints affecting the enterprises have been significantly hardened*. Nonetheless, the system of firms financing was proved to be leaky: *companies liquidity remained too high*. What is worse, this statement is also true of the households. As for the state budget these constraints have remained essentially unchanged. The state budget still benefits from 'soft' financing, i.e. depending on 'justified' social needs, which can be always justified, rather than on actual economic possibilities.

This syndrome results from the fact that both the systemic sphere undergoing economic reform and economic policy, which uses the framework put in place by that system,

but is under a constant pressure of the conflicting interests of various groups, regions, branches, etc., provides loopholes for the central administration, enabling it to make exceptions. These loopholes create a wide and rapid stream of exceptions. Thus, various exceptions, concessions, reductions, preferences and suchlike proliferated, introducing numerous disturbances in the operation of the reformed economic and financial mechanism. These exceptions took the form of certain systemic modifications and of definite economic policy measures. Some proved more durable, others were annulled or revoked, still others never lived to be formally implemented. The novelization of the package of laws which introduced economic reform, attempted in the autumn of 1986, was a particularly spectacular example of the latter. The attempt failed. What must be stressed, the government initiative with this regard was *de facto* rejected by the Parliament.

Starting in August 1982 the Polish economy recovered its potential for economic growth; the slide in production, which had lasted four years, was checked and there was an upturn in production. The NNI increased by 15.7% between 1983 and 1985 (i.e. by 5.0% annually), investment grew by 29.0% (i.e. by 9.6% annually) and consumption - by 12.2% (i.e. 4.6% annually)¹⁶ (Table 3). These figures could have been recognized as *outstanding* by many international standards, if it were not for at least three phenomena which accompanied this rapid economic growth. First, it was a period of a

¹⁶ *Maly Rocznik Statystyczny 1988, (Statistical Pocketbook 1988), Warszawa: GUS, p.62,65.*

Table 3:

ECONOMIC GROWTH IN POLAND: 1983-1988
(previous year = 100)

Indicator	1983	1984	1985	1986	1987	1988
Net National Income	106.0	105.6	103.4	104.9	101.7	103.8
National Income Distributed	105.6	105.0	103.8	105.0	101.6	103.3
Investment	109.5	112.3	104.9	105.9	105.1	104.1
Consumption	105.8	104.4	102.9	104.8	102.9	102.9
Industrial Output	106.6	105.6	104.1	104.4	103.5	104.0
Export	110.3	109.5	101.3	104.9	104.8	105.5
Import	105.5	108.6	107.9	104.9	104.5	104.0

Source:

Maly Rocznik Statystyczny 1988, (Statistical Yearbook 1988),
Warszawa: GUS, p. 62,65,143,240. Data for 1988 - own forecast.

specific reconstruction after a *catastrophic* economic collapse of the 1979-1982 period, especially with regard to the distributed NNI per capita, which only in 1982 had fallen by as much as 12.3%. This means that by 1985 *not even one fundamental economic indicator had achieved the pre-crisis level*, and by 1987 the NNI was still below this level (Table 4). Second, structural changes which accompanied this economic growth were definitely unsatisfactory. Seen in the light of social needs and adjustment challenges of the world economy, this growth has been largely fruitless. A large part of the national income was in fact a specific production for the purposes of production. Third, to which we shall revert later on, the positive effects of economic growth were largely - and sometimes wholly - offset by inflation accompanying economic growth, although it must be stressed that its rate gradually declined during the implementation of the stabilization programme which went along with the 1983-1985 plan.

It is hard to say whether the rate of economic growth could have been higher in these years or whether it should have been higher at all. Maybe yes, but the *problem lies in the structure rather than in dynamics* and from the former viewpoint, the changes were definitely unsatisfactory. It is all the more important, because structural transformations carried out (or rather those which failed to be carried out) in that period have had a major impact on development processes and tensions in the subsequent years.

Table 4: MAIN ECONOMIC INDICATORS IN POLAND

Indicator	1982=100	1978=100
	1987	
Net National Income	123.3	98.8
National Income Distributed	122.8	89.1
Investment	143.5	55.0
Consumption	122.1	108.7
Industrial Output	126.6	109.6
Export	134.5	121.1
Import	135.1	93.9

Source:

Mały Rocznik Statystyczny 1988, (Statistical Yearbook 1988), Warszawa: GUS,
p. 62,65,143,240.

Another question, where the answer is even more difficult, concerns the origins of the growth rate achieved between 1983 and 1985. The question is: *To what extent economic growth had been founded on the autonomic, defensive anti-crisis mechanisms, how helpful was economic reform and lastly, to what extent was it supported by the state's economic policy?* It would appear that any automatism in overcoming the crisis is the least likely source capable of fuelling such economic growth, since there is no such mechanism in the socialist economy.

For all the criticism we may now have for the early stages of economic reform, it had no doubt contributed to reversing the catastrophic trends, which dominated the Polish economy until mid-1982. The reform tapped at least some of the reserves which were still available in the economy and checked the further slide into economic disequilibrium.

On the other hand, it is hard not to appreciate the impact economic policy has had on real economic processes. If we forget for a while about the numerous negative aspects of this policy (some were already discussed, we will still revert to others), we must admit that it did contribute to the strengthening of growth processes which were then so difficult to initiate. This comment is valid with regard to *both stabilizing policies implemented in the 1982-1985 period: the one derived from the logic of martial law (especially in the initial period) and the other, typical of the newly established, reformed logic of economic performance.* I must

also add, that these policies involved a number of elements which were in clear contradiction with one another, which must have had an impact on the results eventually achieved in real economic processes.

It would appear that the positive, on the whole, developments in real economic processes, must have had an influence on the political determination to carry on with the reform. The Office of the Government Plenipotentiary for Economic Reform was wound up in mid-1985 and the Planning Commission of the Council of Ministers took over some of its duties. There have been other, less weighty institutional changes. In a way, however, this was an *attempt to slow down the pace of the reform of the economic system*. The process was to be continued, but it can be said that the assumption was made, that the most important part of the reform had already been completed.

The same period witnessed a slowdown in economic processes. The NNI growth rate fell from its 5% p.a. average in the years 1983-1985 to 3.5% between 1986 and 1987. There was a parallel decline in the growth rate of investment outlays (to 5.5% p.a.) and consumption (to 2.6%)¹⁷.

Processes occurring in the control sphere (systematic reform and economic policy) and those affecting the real sphere (economic growth and structural transformations) led to

¹⁷ *Maly Rocznik Statystyczny 1988, (Statistical Pocketbook 1988)*, Warszawa: GUS, p.62,65.

a new wave of discussions about the indispensable economic changes in Poland. They focused on the acceleration of reformatory activities and a re-evaluation of the priorities of economic policies. These debates eventually led to the making of political decisions on the launching of *the second stage of economic reform*. This implies an appraisal stating that reform (since that moment referred to as the *first stage*) have failed to yield the desired effects and also determination to carry on with the task.

2.6 Second stage of economic reform

Conscious of very animated discussions amongst various groups of the population, the X-th Party Congress held in summer 1986, formulated the task of the elaboration of a programme for the implementation of the second state of economic reform. Another postulate was worked out the *Programme for the Money Consolidation* (Programme 1987). The first postulate concerned another package of measures in the systemic sphere, while the second - a new stabilization programme intended mostly to curb inflation, which was increasingly getting out of hand; planned indices concerning price and wage increases in the years 1986-1987 had been exceeded by nearly 50%. To make things worse, shortages were becoming ever more acute.

The drafts of both documents were ready by spring 1987 and submitted - in line with the already compulsory practice of consultations and negotiations - to public discussion. It

is worthwhile to devote some time to the maturing of these programmes, as they seem to offer certain insights which might be interesting for the future.

It was assumed that these programmes were to be compatible with the 1986-1990 plan, which had been already adopted. They were to complement and support one another, though each was to put the emphasis on different areas of the economy and of the economic mechanism. The programme for the implementation of the second stage of economic reform had to be comprehensive and, quite naturally, it was broader. The second programme was anti-inflationary and was also supposed to embrace measures designed to *enhance the role of money*. It involved a narrower range of measures, many of which overlapped with endeavours, which were to be implemented in the control sphere under the programme for the implementation of the second stage of economic reform.

It came out, however, that there was only one, but crucial point, where these programmes were not compatible and actually proposed fundamentally different approaches. This point concerned the price policy and the system of price formation. There was no way the differences with this respect could have been bridged. While the *Programme for the Money Consolidation* postulated measures consisting in the *liberalization of pricing principles*, paralleled by tight money supply policies, which was intended to check price hikes through a relative limitation of firms sector liquidity, the programme for the implementation of the second stage of

economic reform assumed another major, centrally coordinated price reform. Under the first conception, inflation in 1988 was to stay at about twenty per cent,¹⁸ while the second programme called for a nearly 60% price growth over that year. Following further discussions, this index was reduced to 44.5%.

Despite unfortunate experiences connected to the price operation of the beginning of 1982 and its repetition, though on a smaller scale, in the following years, the second conception prevailed. Hence, it was the programme for the implementation of the second stage of economic reform which was submitted for acceptance. The most important point of this programme failed to take account of the suggestions put forward in the *Programme for the Money Consolidation*. This conception was submitted to a referendum, which was a new element in reform 'running in' since. The last referendum was held in Poland back in 1946.

The results of the referendum with regard to the question about economic reform¹⁹ were hardly surprising. The question was about the respondents' opinion on the acceleration and radicalization of measures introducing economic reform. This involved the whole reform package, more or less known to the

¹⁸ The variant of the Programme which was presented to the general public in May stipulated 13%. Eventually, keeping abreast of rapidly changing economic circumstances, the value of this index was adopted at 20% for 1988, 14% for 1989 and about 9% for 1990. See Programme 1987, p.4.

¹⁹ The second question of the referendum concerned the willingness to accelerate institutional and political reforms expressed - in broadest terms - in the further democratization of public and political life.

population, *including another dramatic price reform*. Grave social doubts about its efficiency, as well as the fear of the incomplete efficiency of the proposed compensating measures, prevented the blueprint from gaining the required majority. The majority criterion in the newly created law on referendum was very demanding. It called for an *absolute* majority of all entitled to vote, before a blueprint which was the object of the referendum could become binding for the government. In most countries the majority of those participating in the referendum is enough. Eventually, the majority of those taking part voted in favour of the radical variant of economic reform, but it proved insufficient to ensure that the radicalization of reform become compulsory for the government. Hence, a less radical variant was adopted for implementation and this lesser severity concerned mostly the scale of projected price increases.²⁰

The programme for the implementation of the second stage of economic reform has been evaluated by the World Bank (WB 1987a) as the *farthest reaching intention of a market-oriented economic reform in the socialist countries*. The problem, however, usually lies in the feasibility, rather than in the radicality or progressiveness of the programmes. The former has always been more difficult.

Broadly speaking, this programme, being a continuation of the heretofore reform of the economic system, aimed to extend

²⁰ Unfortunately, mistaken assumptions in pricing policy eventually - perversely - led to price growth on a scale against which the population had voted in the referendum.

and deepen the scope, and to accelerate the pace at which market relations were introduced into the economy, while preserving the important role of essentially indicative long-term planning. It is particularly worthwhile to note several elements which introduced qualitative changes in the system of the economy's performance.

The second stage of economic reform is making further progress as concerns ensuring *equal rights for all forms of ownership in the economy*. Apart from the earlier mentioned legal guarantees, in mid-1988 the government submitted a project of a *Law on Entrepreneurship* to the Parliament. This project specified the principles on which economic activity could be taken up and, generally speaking, was intended to relax the remaining bureaucratic, economic and political limitations in this area. The general concept underlying this law was to enable all wishing to do so, to start business activity, while exceptions from this general principle were to be precisely defined and legally rather than bureaucratically limited. It is hard to foresee the final outcome of these regulations, but bearing in mind numerous problems which will crop up in its practical implementation, we can venture the opinion that the *introduction of the Law on Entrepreneurship may have a crucial meaning in the aspect of the multi-sectoral development of the Polish economy and the creation of the so-called socialist entrepreneurship*. Actually, I think it would have been more appropriate to speak of 'entrepreneurship in socialism', but that is another question.

The establishment of formal - and that includes legal - conditions for setting up and developing the capital market is another important element of the second stage of economic reform. There is a maturing conviction, both among the practitioners and especially among the theoreticians of reform, that *there can be no efficient market mechanism without a capital and money market*. Hence, opportunities were created to issue securities. Thus far, this applied basically only to *bonds issued by companies* (i.e. without title to firm property, as is the case for shares) which could be bought only by state companies. It is, therefore, only a modest beginning of a capital market, or rather the initial stage of experiments in this area. On the other hand, however, it can be seen as a harbinger of an evolution of the system towards the expansion of the market for securities. There are at least two premises to corroborate this conjecture.

First, it is generally known, at least in the market economies, that a capital market tends to make the economy more flexible, streamlines capital flow channels, frequently leading to its more efficient allocation than possible under rigid central planning, especially of the command type. Second, which must be emphasized here, is the opportunity to *increase the savings propensity* of the households and among the firms. This should contribute to increasing the accumulation potential of the national economy, which had suffered a significant decline in comparison with the earlier periods. Moreover - which is connected with the specificity of centrally planned economy and especially with that of the

Polish economy struggling with disequilibrium - *the creation of a capital market will lead to the institutionalization of public debt*, which until now has had the very deleterious form of forced savings of the households, i.e. the so-called *inflationary overhang* (Kolodko 1986a). We shall revert to this problem in Section 6.

Thus, the capital market in Poland is still coming into being. What we have witnessed so far, were only timid experiments, so to say. They merit attention nonetheless, as they are a perfect illustration of the thesis that *implementing certain solutions known to market economies onto an unbalanced centrally planned economy, at the stage where it is undergoing a market-oriented systemic reform, may sometimes produce burlesque results*. While shares or bonds in the market economies are bought to secure income in the form of dividends or interest, in an economy of shortage they may be bought rather to gain access to scarce goods. That was the case in Poland when, for example, a truck factory guaranteed the buyers of its bonds the right to purchase, after a certain time, trucks made by that factory. Bond buyers were otherwise unable to get a title enabling them to buy the trucks, nor could they buy these trucks in the free market, since there is no free truck market in Poland. There is no doubt, however, that such cases are largely due to the *lack of the capital market*, rather than the effect of the first attempts to establish it.

The money is an essential complement of the capital market. Poland has made the first major step towards its creation, consisting in *the reform of its banking system*. As mentioned before, the role of the banking system was significantly modified already in the initial stage of economic reform, i.e. in early 1982 (Ustawa 1982c). The National Bank of Poland has nonetheless remained the *monobank*, meaning that it was both the central bank and one that credited firm and household sectors.

Major changes took place in May 1987, when a network of nine commercial banks was introduced. These banks were set up in regions which concentrate some 80% of banking operations, so far run by the National Bank of Poland. New commercial banks will start normal operations in the beginning of 1989.

This two-tier banking system²¹ - typical of the market economies - should constitute an *essential instrument fostering the shift from fiscal policy now emphasized in short-term stabilization policies and medium- and long-term adjustment and development, towards monetary policy*.

Thus far, mostly for systemic reasons, monetary policy could not have been sufficiently effective, nor could it foster a more extensive use of money in control processes. Also much attention is attached to systemic regulations which

²¹ This system is complemented with specialized banks which serve the savings of the households' sector (both in domestic and foreign currency), the food economy, exports, and foreign trade turnover. It is worth adding, that following grass-root initiatives, a new regional development bank is to be established. It will operate as a company by shares.

are to promote desirable structural transformations and improved economic performance. This applies especially to already adopted laws on bankruptcy and the anti-trust law, which have been so far enforced with very modest results.

Measures aimed at improving the situation in many inefficient companies - taken up within the framework of the bankruptcy law mentioned above - have been only partly satisfactory. We mentioned earlier that the system of firms' financing was leaky and that the budget constraints had been insufficiently 'hardened'. Thus, when banks refused further credits and called up their loans, firms did not always make adjustment capable of improving their financial situation in a lasting way. It was highly unusual for credit suspension to result in bankruptcy.²² There have been few such cases thus far. They were mostly confined to the cooperative sector (especially in agriculture) and to construction firms. The most common method which firms used when credit was suspended was to obtain finance from other sources, usually from the state budget.

This was facilitated by too extensive system of various subsidies and grants and - especially - tax cuts, mostly affecting the wage fund. Thus, this aspect has its political dimension. While the National Bank of Poland imposed stricter criteria in its credit policy in 1987 and sharply cut back on

²² The relevant Parliament act, which laid down the principle of bankruptcy, had been passed already in 1983.

the growth on the money supply,²³ there was a parallel jump in cuts in the income tax that companies pay to the state budget. In 1987 they had increased by 117.6% (!) against 1986. It is obvious that *such a fiscal policy must have had an inflationary and destabilizing impact.*

This is why there are high hopes for the reform of the banking system to more efficiently control the dynamics and directions of money flows in the national economy. It will call for establishment of an *interbank money market*, whose scope should be later extended and also - a clear realignment of the state's budget policy. This policy must be tighter or the instruments of monetary policy will remain as inefficient as they are now.

Speaking of these instruments, it is worthwhile to mention *interest rate policy*. Its short-term goal (though time is extended due to the very high inflation rate) is to achieve a 'normal' state, where the interest rate would be positive in real terms. This is why already in 1987 the central bank had increased its interest rate, both on credits and deposits, but it is still equal to less than half of the inflation rate.²⁴ I believe that the only reasonable way out of this situation would be a policy which would make the interest rate more

²³ The volume of bank credits increased by 17.3% in 1987, against an inflation rate of about 26%, while the NNI in current prices increased by about 28% (Bulletin 1988).

²⁴ For example, households' deposit bear interest rates between 21 and 22% for demand deposits up to 30% for three-year deposits. The deposits and credits of the firms sector bear lower interest. It is obvious that such a situation entails an important redistribution of the national income.

realistic (i.e. make it higher than the inflation rate, which does not necessarily imply that it would immediately become an equilibrium rate for money supply and demand) through the successive lowering of the inflation rate, rather than through a continuous rise in the interest rate following inflation. Thus, assuming that the interest rate in force in 1988 is retained in 1989, there are chances to shift to a positive (in real terms) interest rate in 1989.

Just like careful approach is advised when it comes to the efficiency of monetary policy instruments or to the modelling of structural transformations through bank credits in an economy with severe shortages, moderation is also advisable with regard to the opportunities offered by *anti-trust action*. Despite rather favourable legislation with this regard, the Polish economy is still far from witnessing even the first symptoms of demonopolization, since that can be brought about only by competition rather than centralized efforts aimed at breaking up monopolistic structures. What is more, in a certain sense *demonopolization in the socialist economy appears to be an even tougher task than that in the capitalist economy*.

The economy of shortage favours the petrification of the prevailing, highly monopolistic economic structures. Anti-trust legislation creates only very limited opportunities to oppose monopolistic practices. It is all the more difficult because facing major shortages, a large part of producers (and that includes commercial and service companies) benefit from a

monopolistic position, despite and often insignificant share in production or supplies to the market.

2.7 External implications

Lastly, it can be said that the second stage of economic reform leads to the 'opening up' of the Polish economy to the surrounding world (Mizsei and Rosati 1988). This is consolidated by certain systemic changes, as well as some restructuralization measures and economic policy decisions. The exchange rate policy, the law on joint-ventures and the system of so-called ROD accounts (right to retain a certain proportion of foreign exchange earnings) merit special attention.

There is no doubt that a greater availability of foreign capital could contribute to a far greater efficiency of stabilization processes and to speeding up economic growth in the longer term. This is why the second stage of economic reform provides for a broader opening up to foreign capital.

It is obvious that Poland should go much farther in this area. Thus far, only companies whose foreign owners were of Polish descent, have had some importance. However, in the case of joint-ventures we can observe a *clear feedback between the pace of stabilization and a broader involvement of the Polish economy in the world*. On the one hand, the influx of foreign capital should strengthen stabilization and development and, on the other, its volume will depend on advances achieved by

these processes. There are chances that the second stage of economic reform might result in a certain visible acceleration in this regard.

I believe that the system under which enterprises can retain a certain proportion of their foreign earnings (ROD accounts) has a fundamental meaning for the growth of export, maybe even more important than the so-called active exchange rate policy. These funds can be earmarked for capital goods imports and - especially - for the procurement of imported materials, accordingly to the companies' needs. This system is a very powerful stimulator for starting or expanding exports, as it is often the only way (given the short supply of foreign exchange distributed by the economic administration) to acquire foreign exchange.

The further *decentralization of the system under which companies are supplied with foreign exchange and of the policy of foreign exchange* is one of the more important issues of the current stage of the systemic reform. This is why it is assumed that the amount of foreign exchange retained by the firms will increase. The Export Development Bank (established in 1987) is now organizing auctions, at which firms can buy foreign exchange at equilibrium rates, from other firms which have ROD accounts. This system, however, involves numerous limitations (for instance, the private sector has not the access to these auctions), and has been operating only on a very small, experimental scale. Anyway, these changes are also the symptoms of the increasing *independence of the companies*,

which, we must remember, is to be one of the cornerstones of the Polish economic reform.

Accession to the World Bank and to the International Monetary Fund in 1986 was an important moment in the process of the reform and stabilization of Poland's economy. This access had been denied for several years for political reasons, mostly due to economic sanctions imposed on Poland by the United States following the declaration of martial law in December 1981 (Andrews 1988). Both these organizations have made a positive appraisal of the programme for the implementation of the second stage of economic reform. They declare they are ready to provide financial assistance and there are a number of investment projects in preparation which might benefit from their credits. What is decisive, however, is not the programme of the continuation of economic reform and the professed desire to accelerate it, but that what is actually done and the progress achieved (Gomulka 1988, Marer 1988).

In this aspect, the years 1988 and 1989 may be every bit as crucial as 1982 was. Its beginning, however, was hardly the best possible, largely due to the unsuccessful, entirely abortive attempt of the price and income reform of February 1988, to which I shall revert later on, as it is connected with at least several problems, both theoretical and practical, which are still waiting to be solved.

Far-reaching changes - at least formally - have been made in the institutional sphere. The Ministry of Industry, which now supersedes several earlier ministries, is to concentrate on long-term policies designed to promote technical progress and shape industrial structures. A new banking system is under development, an anti-trust office has been set up in the Ministry of Finance, the function of many ministries are evolving towards a greater emphasis on the functional aspect of their activities. These are no doubt symptoms of progress with regard to the management of the national economy, though they do not, unfortunately, reach far enough.

Some recent developments seen as major threats to the acceleration of the systemic reform have led the authorities to make an *unorthodox move*. Certain economic processes in the first quarter of 1988, which were all the more adverse because they occurred in times of mounting inflation and uncontrolled redistribution, have led the authorities to pass the so-called *extraordinary powers (or special law) for the Government*.

They were intended to force various bodies of state bureaucracy and economic administration, as well as enterprises to act in line with the assumptions of the programme for the implementation of the second stage of economic reform. There is always the risk that such regulations may be abused and serve purposes opposed to what was intended. The Parliament approved these powers for a period between April and the end of 1988. While they are in force, the government has made several apparently spectacular

moves, calling off the managers of inefficient companies and winding up more than a score of the latter. Obviously, this failed to bring any structural effects. Moreover, certain extraordinary measures were introduced, consisting in the additional taxation of certain companies, for less than full utilization of their fixed assets. There were also some administrative measures designed to check the pace of the inflationary rise in prices and wages. *All this failed to bring visible effects.*

This is why recourse to such an instrument of stabilization policy as these extraordinary powers for the government must raise *grave reservations and doubts* concerning their purposefulness, not to mention efficiency. For the problems connected with the process of stabilization and adjustment of the Polish economy - and of other socialist economies - are much deeper and complex than it might seem on the basis of the digest of their situation presented here. It is worthwhile, therefore, to look somewhat deeper into the nature, mechanism and consequences of these processes, as well as to the dilemmas and challenges they bring along.

3. REFORM OF ECONOMIC SYSTEM: SOME GENERAL COMMENTS

3.1 Lessons from historical experience

Economic reform currently implemented in Poland - as well as in the other socialist countries - are hardly the first of such efforts. Actually, they have a long history.²⁵ First attempts at reforming socialist economies had been made back in 1956-1958. It was a reaction to the compromised, utterly bureaucratized, Stalinist system. Originally, this system had caused a number of changes in the economy. Among other things, it brought essential transformations in economic structure. In Poland this found its expression mostly in the rapid industrialization and the creation of the 'groundwork' for further industrial development, especially of heavy industries. The economic structure thus created and the mechanism of economic operation, however, were increasingly inert and inflexible. They also failed to keep abreast with quickly rising and changing social aspirations. The need for far-reaching changes was becoming increasingly pressing. Thus came about the first reforms of the 1956-58 period.

Efforts made in that period failed, because the leadership lacked the determination required to consistently carry out the reforms. At the same time, that what was to be changed was proving increasingly resistant. *Both the system and social structure, which went along with it, proved*

²⁵ More on this issue see - among others - Wilczynski 1972, Wiles 1977, Zielinski 1978, Nove 1981, Kornai 1986c, Brus 1988.

exceedingly viable and adept at self-perpetuation. Several years went by and reforms collapsed.

Later, Hungary tried to draw some conclusions from earlier Polish failures. Hungary, in turn, is frequently cited as an example for the Polish reform of the eighties. This history of these and other reforms in Poland and other socialist countries shows that four conditions must be simultaneously satisfied for any reform to succeed.

First, society must be willing to carry out the reform and to bear the inherent cost. Second, determination is required on the part of the political authorities. Third, knowledge is required to supply the theoretical foundations of the new system which is to be put in place. Lastly, reform needs resources, to facilitate the necessary changes by the opportunity to reach to the reserves, at the time when the 'old' is no longer there and the 'new' is not yet installed.

One can hardly find an example satisfying all these conditions. Our knowledge in these matters is no doubt still limited. As it has been said by Czeslaw Bobrowski, a senior Polish economist, our knowledge expands as an arithmetic series, while problems crop up in geometric progression. And though we know more and more about how to reform the economy, the target system is still unclear.

Anyway, it is doubtful whether it need be first described, because it should first achieve some level of

maturity and come into being. The intellectual impatience of those requesting the formulation *target model* is comprehensible. Poland had been witnessing in 1988 a widespread and animated debate published in the *Zycie Gospodarcze* weekly, under the title *The Unknown Variables of the Target System*. One must understand, however, that first many generations had to build churches with soaring spires and sharp window arches and only later, others noticed it, described, systematized, generalized and called it the *gothic-style*. Likewise, *the question about the shape of reformed socialism* will probably wait long for a satisfactory answer.

The population of Poland display much interest and support for economic reform, but also a rising reluctance to bear the inevitable costs of systemic changes. This syndrome reflected in paying lip service to reforms, while passively (or sometimes actively) countering them when it comes to concrete action entailing costs, resembles the well-known English saying about the cake, that one would like to both eat and keep. Public opinion polls provide corroborating evidence, especially with regard to price and income policies (Kwiatkowski 1987). Populations declare they favour price levels and ratios based on market categories, but raise quite understandable protests when this calls for price hikes.

The answer to the question on the leadership's determination in the implementation of systemic reforms is more complex. The leadership is not homogeneous and the power elite reflects the same contradictions which are present

within the society. And the approach of the leadership toward the reform has not been the same all the time. It would appear however, that now, like never before, leadership wishes to go ahead with the reform. This determination is a function of many factors. The deep conviction, that *there can be no further efficient performance of the economy without a major overhaul*, is foremost amongst these factors. If reform favour the achievement of better performing economy, then there is a natural compatibility between the authorities and society's interests in its implementation. Such compatibility can be a very strong factor stimulating reform.

Coming to the fourth factor which offers a *chance* - as we can at most speak of a chance - of successful reform, that is material resources, Poland is no doubt worst off. The country has only minimal reserves and a foreign debt, which is a major burden for the national economy, and this debt very seriously limits the margin of freedom required for the success of the reform.

3.2 Market and central planning

Economic reform concepts in Poland are now based on a far broader introduction of market relations into the economy than considered ever before. Contrary to many past statements, proper to the stage of *administered (bureaucratic) socialism*, came the realization that centralized directive-type (or command) management cannot cope with the optimal allocation of capital and labour. This inability led to an ever greater complication of economic, commercial, financial, technological

and other relations, and eventually to a relatively lower economic performance and labour productivity.

The centralized management system of real socialism was thus unable to cope with the allocation of limited material and human resources. In Poland, this system was generally referred to as *directive-type*, or more precisely, *directively-distributory* management, which was to emphasize the role of the central, bureaucratic rationing of scarce means of production. One should stress here, that the economic system proper to this stage of the development of socialism has created its own vocabulary, which is why it is often difficult to find even a verbatim translation of many concepts, characteristic of the economic vocabulary of the centrally planned economies, into the English language.

Hence, economic reform in Poland aims to base economic relation on market categories. The role of money, prices, credit, interest rate, exchange rate and suchlike is significantly enhanced. The conviction that it is necessary to call upon these market categories is derived from several premises.

First, the market is supposed to bring discipline into economic processes; put a rein on the excessive expansion drive proper to bureaucratized central management. This drive used to lead to nationwide overinvestment, with all the adverse consequences for economic performance. *The passive role of money and of the market meant that they were secondary*

to *physical processes*. Economic reform is designed to inverse this relationship, that is to subordinate material processes to monetary processes, which should facilitate the balancing of the main inputs and outputs in the economy.

Second, market categories and - most of all - resultant dear money policies as well as hard budget constraints are intended to create the systemic premises for the operation of economic constraints with regard to various participants of economic processes - both firms and households. Until now, only the household knew the hard budget constraints, while all attempts of applying them to state firms failed, precisely because of the too passive role of the market and money. The point is therefore to enable the market competition, to force the participants of economic processes to choose between better economic performance and elimination.

Third, the market is a mechanism whereby the output structure (in the short term) and the investment structure (in the long term) adapt themselves to social needs and demand.

Certain strategic and infrastructural investment projects excepted, command central planning was and remains unable (despite major advances in planning methods and computing techniques due to computerization) to initiate processes required to adjust the volume and structure of the supply and demand. This failure is especially visible with regard to consumer goods.

The role of the market and of its categories and mechanisms in the system of the national economy's operation has now become the central problem facing the theory and practice of systemic reform in socialism. It is hardly a coincidence that the course of discussions on this subject is similar in all countries which initiate reforms. Moreover, arguments raised with the connection to past reformist efforts are brought over and over again.

In discussing market-oriented systemic reforms one should remember that socialism was originally conceived as an *anti-thesis*, a negation as if it were, of the capitalist economy based on the market. Nowadays attempts are made to implant elements of the market economy *into the socialist system*, but certainly *not to replace* the latter with the market economy. Comes the natural question: *What are the limits to market mechanisms and relations in reformed socialist economy?*

There are conflicting views on this matter. In defining the extreme attitudes with this regard, Kornai (1986c) referred to the concept of nearly complete introduction of market relations as *socialist Friedmanism* and coined the term *Galbraith's socialism* for those advocating the active role of the state in economic processes to be maintained. While Kornai's observations were made drawing on Hungarian experiences, they are true for Poland and, I believe, also for other centrally planned economies.

Polish debates of the eighties concerning these matters reveal an interesting evolution of the views. What makes it all the more interesting is the fact that this evolution in theoretical views is followed (with a certain natural time lag) by an evolution in politicians' opinions and eventually in the policies of systemic and institutional changes. Initially, reform was to consist mostly in a narrower application of certain market elements. Then it was decided that the scope of market influence was to be extended, both with regard to what we may call its scope and depth. This is how we came to the discussions about the overriding role of central strategic planning and a still auxiliary and corrective role of the market. Then came the further enhancement of the role played by the market. This was clearest (both in theory and in certain practical solutions) in a further expansion of the reach of market categories: from the consumer market alone (this was to be reflected, among other things, in the relaxation of price controls by the state) to the means of production. In the next stage there is more talk about the creation of money and capital markets and about a labour market. It can be also heard that the reach and influence of the market mechanisms are to be still deeper and stronger.

Hence, the market is no longer discussed as a secondary, corrective instrument, but as an 'equal partner' of the central plan. Economic processes are to be no longer guided exclusively by the *visible hand* of the central planner, but also, to an increasing degree, by the *invisible hand* of the

market. It is in this context that the so-called *planned and market-type* model is discussed. One can already anticipate that the next stage should inverse the stress - and though this would represent a qualitative change - put the emphasis on the examination of the essence and features of a *market-type and planned model* (Nasilowski 1988). We thus have a complete reversal of the fundamental ideological and political options. Until now, the market was supposed to correct, to some extent, the shortcomings and inconsistencies of central planning. Under this new model approach *central planning is to correct the negative impact of powerful market influences*.

It could be said for practical purposes that Poland is now in a transition period from the model of *planned and market-type* to the model of *market-type and planned* socialism. The logic of this historical process appears to be quite clear. Similar observations can be made with regard to Hungary, Yugoslavia and - to a lesser extent - to China²⁶ and - as time passes - they might come true for the Soviet Union and, at a later date, for the remaining socialist countries.

Only such a broader context affords the comprehension of the processes connected with the organization of e.g. the capital market, calls for a true labour market (that is including unemployment) or the attempts to commercialize a banking systems. Thus, for example, only when the conviction about the indispensability of the capital

²⁶ On the economic reform in China see - for instance - Ellman (1986), Feuchtwang and Hussain (1983), Harding and Hewett (1988), Kosta (1987), Perkins (1988), and Quaisser (1987).

market matures, banking reform is initiated. This reform would have no sense under the traditional setup, as it could not have produced any desirable effects. It is precisely under such a set of circumstances that a network of commercial banks has been set up in Poland in 1988-1989.

The commercialization of the banking system is an institutional and systemic measure designed to promote a further *marketization* of economic relations, especially capital allocation, the balancing of supply and demand (Szeplaki and Taylor 1972), and to enhance economic performance in production and investment through the introduction of hard budget constraints.

The creation of a two-tier banking system, however, has a deeper sense. It is in fact an *institutional confirmation of the increasing role of money and market relations in the socialist economy*. It is only within such a banking system that money can play a more active role (Gorski-Jedrzejczak 1987) and influence the processes of production, trade and distribution. This background is also necessary for carrying out active monetary policies which, as mentioned before, had been previously subordinated to planning in physical units. This evolution in the approach to the steerage of economic processes in Poland is reflected in the transition from separated input-output planning in physical units and financial planning to an integrated system of material and financial planning (to be introduced in 1989).

The integrated material and financial plan is the practical reflection of the transition from directive-type planning to the model of market-related planning. Radical systemic changes as well as the changes in economic policies provided for in the programme for the implementation of the second stage of economic reform (Programme 1988) are the natural steps capable of bringing changes in this *status quo*. The nationwide referendum, which preceded the adoption of this programme, reflected the second fundamental feature of the systemic reform in Poland: the *democratization of political relations*. It is generally accepted, in scientific papers, press statements and official party documents, that the democratization of economic relations, expressed primarily in the introduction of market²⁷ is impossible without democratization in the broader sense.

3.3 Control and real spheres of the economy

As we said already, the second stage of economic reform constituted a continuation of developments started in the years 1981-82 and it was a *de facto* admission that many earlier attempted measures had failed to bring the anticipated breakthrough in overall economic performance in Poland. How can one therefore evaluate the effects achieved so far by the reform of the system of the economy's operation in Poland and what are the principal barriers to its effective implementation?

²⁷ And it is well known that the market does not yield to the pressures of various group interests like central command planning did.

Farthest reaching changes were implemented in the *control sphere* of the national economy. The current system of the economy's performance differs significantly from that which had led to the deep crisis in the late seventies. It is dominated by indirect steering, making widespread use of numerous market categories and monetary policy instruments. And though there is a *qualitative* difference between the former and present systems, it cannot be said that the economy was freed of its crisis-prone nature.

One might say that the system established in the eighties is a hybrid and thus not always comprehensible - not only for the general public but even for professionals. This system combines the relics of the old system with the elements of the new. It interweaves the elements of central, bureaucratic rationing of the still scarce means with market allocation methods. Elements typical of wartime economy crisscross with market mechanisms. One may therefore advance that *heterogeneity and the incoherence of certain solutions, brought into the economy by the introduction of the reform, are amongst the fundamental features of the performance of the current economic system*. Obviously, this has an adverse impact on the real processes and renders possible many ill-conceived actions in economic policy, especially with regard to economic stabilization and vis-à-vis the curbing of inflation.

The drastically low starting point in 1982, due to recession, is not in itself a satisfactory explanation of the

still low degree of social satisfaction.²⁸ Thus, the answer must be sought elsewhere. It would appear that two sets of psychological factors are essential with this regard. First, there is a big and periodically growing (which makes things still worse) gap between social aspirations and the degree of their satisfaction. The point is that the population feels that economic situation 'is deteriorating' when the gap between consumer expectations and the real consumption level grows, even if the absolute level of consumption had statistically increase. This state, which I elsewhere (Kolodko 1986b and 1987c) called *the paradox of the lower degree of satisfaction of the needs at a higher consumption level*, could be diagnosed in Poland between 1983 and 1988, despite an absolute growth in the real income of household sector as well as in the consumption level. This is reflected in a situation where the population claims that they are 'worse and worse off', while the leadership makes futile attempts at convincing the society that 'things are on the mend'.

3.4 Inflationary constraints

This problem has at least one more dimension. It is connected with high inflation, in both forms typical for centrally planned economies in periods of market oriented reforms, that is open (price) inflation and money-balance (repressed) inflation.²⁹ Facing high inflation, the population

²⁸ Nearly all representative public opinion polls in Poland provide concurrent results; see Kwiatkowski 1987.

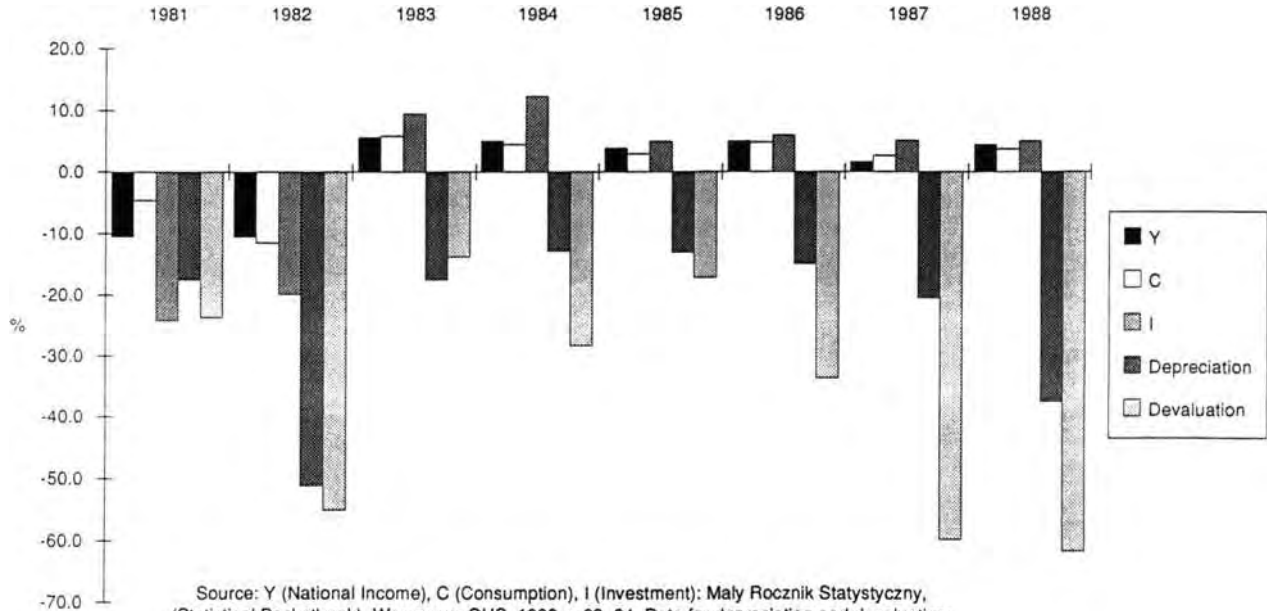
²⁹ The term *money-balance inflation* (to distinguish it from *price inflation*) applies to *repressed inflation*. Emphasis is laid on the

tends to evaluate their economic situation in the light of money's purchasing power and exchange rate, rather than by the indicators which illustrate actual economic growth. Inflation invariably entails depreciation and in a country like Poland, with a weak and inconvertible currency, also far-reaching devaluation. Recent trends with this regard are illustrated in Figure 2.

Given these strong inflationary processes there is little wonder that the population has a sceptical, or even clearly negative, attitude towards economic reform and other complementary stabilization measures. *Inflation has become one of the most painful barriers, effectively obstructing the introduction of new systemic solutions provided for by the economic reform.* Initially the process of the opening of the inflation was to be one of the conditions facilitating the implementation of economic reform. The object was to balance the market and to eliminate acute shortages, and not only in the consumer market. Given, however, the strong inflationary influence of structural and systemic factors it took on a lasting character. Eventually, certain newly introduced elements of the new economic and financial mechanism also proved inflationary (Kolodko 1988). Hence, *opening inflation, which was one of the premises required for the implementation of economic reform, became a fundamental barrier and probably the most difficult to overcome* (Shmeliov 1987 and 1988). This statement is all the more important because the whole complex

consequences of this process, as it results in involuntary savings of the households, due to the shortage of consumer goods (Portes 1981 and 1984, Kolodko 1986a, Pawilno-Pacewicz 1986).

FIGURE 2: Economic Growth and Money in Poland (1981-1988)



Source: Y (National Income), C (Consumption), I (Investment): *Mały Rocznik Statystyczny*, (Statistical Pocketbook), Warszawa: GUS, 1988, p.93, 94. Data for depreciation and devaluation: National Bank of Poland and own calculation, for 1988: own forecast.

of new systemic solutions has been conceived for a balanced economy, since it is only in a balanced environment that the market mechanism can operate efficiently.³⁰ What is more, a two-digit inflation³¹ effectively kills all incentive systems and one can hardly expect reform to succeed without them.

Disequilibrium is the fundamental obstacle in the broader application of the 'triple S' formula mentioned earlier. This is why the Polish economy still features a high share of grants and subsidies for unprofitable production and also a strong dose of fiscalism, expressed in the heavy taxation of the enterprises. One must note here that taxes imposed on the households have so far played no major role.³² There still is a fair proportion of unprofitable products, which imposes a heavy burden on the state budget. The budget has been running deficits for many years due to taxes being insufficient to balance budget expenditure. Budget deficits, an important contributor to demand inflation, have been running at 3 % to 5% overall state expenditure. Given that there are no government bonds and no institutionalized public debt, this gap was automatically filled by central bank credits. The clearly inflationary practice of printing paper money with no backing was the source of these credits.

³⁰ This is also the point stressed in the World Bank and the International Monetary Fund journal (namely *Finance & Development*) in the article written by Karen A. Swiderski: *...systemic changes are unlikely to be successfully implemented unless macroeconomic equilibrium is achieved and maintained through sound finance and incomes policies.* (Swiderski 1988, p.24).

³¹ Its rate in Poland in the years 1981-1988 was 35 % on the average.

³² Except indirect taxes included in the retail prices of some consumer goods in the form of the turnover tax.

Poland's stabilization policy with regard to prices involves sharp contradictions. On the one hand, it is necessary to further liberalize pricing principles and, on the other, this might step up inflation. This is why *pricing policies are a politically sensitive issue*. Attempts made thus far to change the price structure have failed to yield the desired effect. The price structure still differs considerably from the structure of social production costs and thus it cannot properly inform producers and consumers about the real scarcity of particular products and services. This also prevents a part of the outlays from being allocated according to efficiency requirements.

A specific feature of the Polish price system is the relatively low level of the prices of subsistence goods and services: food, some types of clothing, housing rents, public transport, medical services, etc. Attempts to increase these prices in order to cut back on subsidies (which actually limits income redistribution via the state budget) run into strong social opposition, including strikes, and entail an almost automatic compensation for any increases in the cost of living due to these price increases. That was the case e.g. in 1988, when - following another attempt aimed at major changes in the level and structure of prices - the inflation spiral was wound once again. In the first half of 1988 the average price level was increased by about 49% and average wages increased by about 53%. Parallel to that, there was an

increase in on-wage household incomes, which brought clearly inflationary (instead of deflationary) results.

Hence, after getting involved in some of the intricacies of the operation of financial, banking, tax, price and organization as well as institutional systems, or of the investment policy and foreign trade, it can be said more general that *the problems of prices, disequilibrium (in all its aspects) and inflation are pivotal to the stabilization of the Polish economy and its adjustment to internal and external conditions.*

4. STRUCTURAL TRANSFORMATIONS IN THE EIGHTIES

4.1 Trend of inertness

There is a viewpoint from which one can say that both systemic changes and those concerning economic policy are only instrumental with regard to the sphere of real economic processes in the national economy. It is only the latter which ultimately determines the structure of the net product, and thus the ability to meet social demand. This is why the efficiency of reform can be viewed in the light of what has been achieved with regard to structural changes, flexibility of the economic structure and its propensity to adjust to changing internal and external constraints.

The economic structure established in Poland over the past decades is rather inert. It must be emphasized that the only programme of quality structural changes which has been successfully implemented thus far, was that of *accelerated socialist industrialization*, implemented in Poland and other European socialist countries in the fifties. The following decades saw a replication of this programme, with greater or lesser alterations, which resulted in the petrification of the existing economic structures, founded on the dominance of heavy industries. In Poland these were mainly coal mining and the steel industry. The structure of Poland's NNI is illustrated in Table 5.

Table 5: GROWTH AND STRUCTURE OF NATIONAL INCOME IN POLAND
(previous year = 100)

Indicator	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	
1 Total	107.9	110.3	111.0	110.6	108.9	107.1	105.7	104.0	99.0	95.7	88.8	95.2	106.0	105.5	103.3	104.8	101.8	
2 Socialized Sector	108.6	111.1	112.5	113.3	111.4	108.6	105.9	103.0	99.1	97.1	85.4	94.1	105.5	105.8	103.8	104.4		
3 Non-Socialized Sector	104.6	106.6	104.1	97.4	94.8	99.6	104.6	109.6	98.3	88.1	107.5	100.0	108.4	104.1	101.4	106.4		
4 Industry	108.2	110.0	111.4	112.2	110.8	109.5	108.4	103.6	99.3	97.5	86.4	96.3	105.7	105.2	103.9	104.3	103.2	
5 Construction	104.9	120.8	116.3	114.2	111.8	103.2	101.7	100.7	95.2	81.2	75.7	91.5	107.3	107.8	104.2	104.1	102.3	
6 Agriculture	108.0	105.7	104.4	98.3	93.8	101.6	100.3	109.3	94.9	88.2	101.6	105.7	105.5	105.3	100.3	105.8	92.5	
7 Forestry	100.0	99.9	104.6	108.3	108.1	108.1	91.8	98.7	94.2	104.2	105.9	109.6	112.7	107.8	101.6	105.4	102.6	
8 Transport											91.2	85.2	106.8	108.5	103.5	104.2	103.8	
9 Communications										107.0	99.2	107.4	124.0	107.0	104.4	107.4	109.8	
10 Trade	108.5	109.9	112.5	113.3	111.7	108.0	105.6	100.4	103.0	100.1	92.8	87.1	104.4	103.5	104.2	105.3	104.8	
11 Other Non-Material Service						106.3	109.9	107.8	133.3	98.9	99.5	96.9	112.4	105.8	103.5	105.3	102.5	
12 Housing & Non-Material Community Service	102.1	113.2	127.2	118.1	115.6		117.9	107.0	105.3	104.2	104.7	104.8	98.5	110.8	106.0	104.2	106.5	103.1

Source: *Rocznik Statystyczny, (Statistical Yearbook),*
Warszawa: GUS, various issues.

Looking at changes which took place in the eighties, one can easily observe that they were not particularly profound. It is against this background that the process of Polish economic restructuring can be said to merit a negative appraisal. Poland's economic structure has retained its high proportion of energy- and material-intensive industries. They are not sufficiently innovative, require important outlays of labour and, moreover, often call for hard currency supplies. The latter is a legacy of investment projects implemented in the seventies, when Poland drew heavily on external sources for financing its development. This increased output capacity was connected with raw materials and supplies which had to be imported. Given Poland's current debt crisis, this remains one of the major causes of the less than full utilization of production capacities, which are estimated to be running at 75 to 85%, depending on estimation method used.

Low export ability is another negative structural feature of the Polish economy. Basic relevant indices are provided below (Table 6).

The share of particular branches of economy in overall investments is one of the traditional indices illustrating the modernity of economic structure. Recent changes are inadequate also with this respect (see Table 7), as there has been no sufficient growth in hi-tech industries. Thus the competitiveness of the Polish industry is relatively low in comparison with its overall industrial potential.

Table 6:

POLAND'S FOREIGN TRADE: 1971-1987
(previous year = 100)

Indicator	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
1 Import	113.8	122.1	122.6	114.2	105.0	110.3	100.4	101.5	98.8	98.1	83.1	86.3	105.2	108.6	107.9	104.9	104.5
2 Socialist countries	110.3	110.1	112.7	111.1	97.9	107.8	112.3	104.0	101.7	102.4	93.7	94.4	104.4	109.2	104.6	109.4	100.4
3 Other countries	120.7	146.6	137.8	119.2	112.2	111.4	89.1	98.0	95.5	92.8	68.5	75.8	106.6	107.4	113.4	98.1	110.7
4 Export	106.5	115.2	111.0	112.8	108.3	105.4	108.8	105.7	106.8	95.8	81.0	108.7	110.3	109.5	101.3	104.9	104.8
5 Socialist countries	106.9	115.9	112.0	116.0	109.6	99.7	110.6	107.5	109.6	90.5	83.0	116.6	108.3	110.0	108.1	107.6	102.8
6 Other countries	104.9	114.8	110.9	105.9	105.8	112.3	104.0	102.9	102.1	105.0	77.9	100.9	112.4	109.0	93.5	101.4	107.1
7 Index of import prices	98.2	99.6	108.8	116.9	112.0	100.4	105.5	103.8	108.0	109.5	108.9	161.5	105.3	114.7	122.0	117.1	140.8
8 Index of export prices	102.4	101.4	105.7	116.4	115.6	102.4	103.1	103.8	105.3	107.7	108.5	160.0	101.1	113.1	125.0	119.3	146.0
9 Terms of trade	104.3	101.8	97.1	99.5	103.2	102.0	97.7	100.0	97.5	98.4	99.6	99.1	96.0	98.6	102.5	101.9	103.7
10 Net National Income	107.9	110.3	111.0	110.6	108.9	107.1	105.7	104.0	99.0	95.7	88.8	95.2	106.0	105.5	103.3	104.8	101.8

Source:

Rocznik Statystyczny, (Statistical Yearbook),
Warszawa: GUS, various issues.

Table 7: STRUCTURE AND RATE OF GROWTH OF INVESTMENT :
1971-1990 (five years periods; in %)

	1971-75	1976-80	1981-85	1986-90 (Plan)	Increase 1986-90/ 1981-85
Energy	9.0	8.9	10.7	12.2	42
Metallurgy	5.4	5.6	1.8	2.8	89
Engineering	9.6	9.2	6.4	7.0	36
Chemical	4.2	4.2	2.8	3.5	53
Light Industry	3.1	1.7	1.3	1.6	48
Food Industry	4.4	3.3	3.5	4.1	44
Other Industry	5.3	4.2	2.5	3.3	66
Agriculture & Forestry	15.0	16.7	19.0	17.3	13
Transportation	10.5	8.7	6.9	7.3	30
Other Mat. Prod. & Serv.	11.1	12.1	12.0	11.0	14
Total Material Prod.	77.6	74.7	66.8	70.0	30
Housing and Local Services	16.5	19.9	25.6	21.3	3
Education	1.8	1.5	2.4	2.9	51
Health	1.2	1.3	2.5	2.7	32
Other Non-Material serv.	3.0	2.7	2.7	3.2	44
Total Non-Material Serv.	22.4	25.3	33.2	30.0	12
Total	100.0	100.0	100.0	100.0	24

Source:

Commission of Planning of the Council of Ministers.

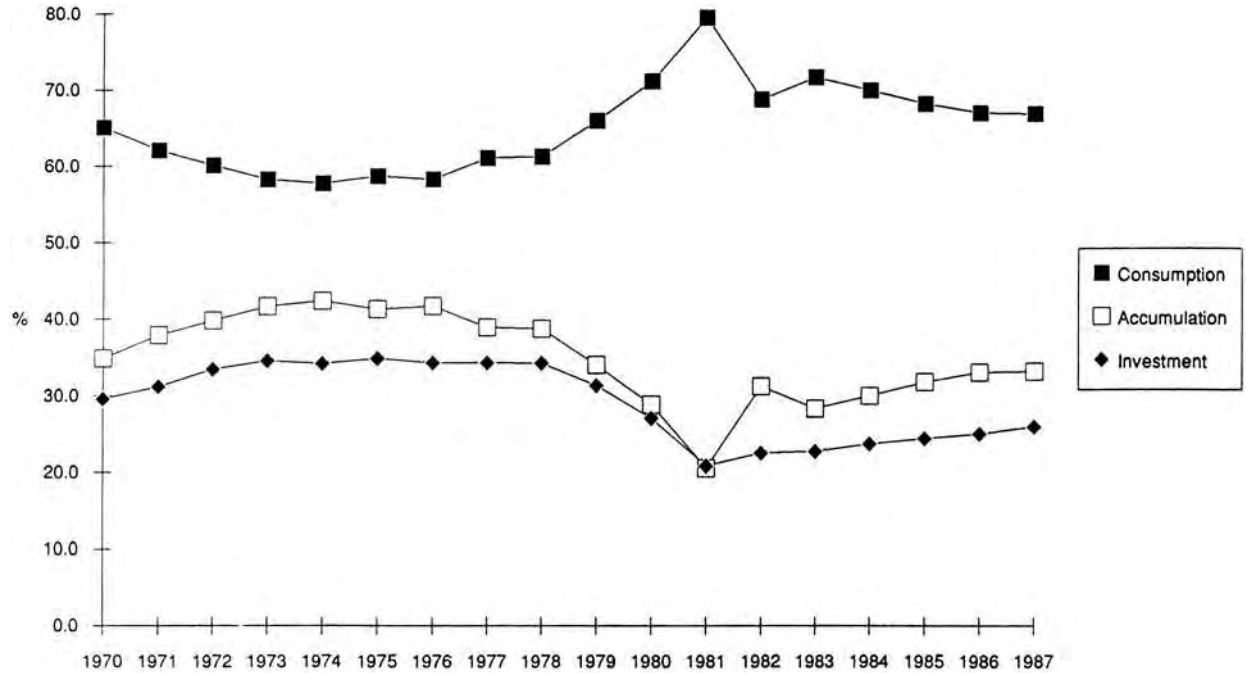
A too low share of consumer product industries in overall output is another structural shortcoming; it is one of the major factors contributing to permanent, strong inflationary pressure. *The economic structure established over the years has produced a system where effective demand remains always ahead of the supply.* Given the lack of systemic (monetary) constraints and "soft" economic policies applied to the firms, inflation is chronic.

4.2 Crisis and structural adjustment

Economic crisis can be also understood as a process whereby desirable economic proportions are being restored after a long period of mounting disparities. The Polish crisis also corresponds to this definition. But, while it might appear that in the recent years Poland has struck the balance in the final distribution of the net product between investment and consumption (see Figure 3), crisis-forming proportions have remained intact in other areas. Apart from earlier mentioned relations in the areas of production, investment and consumption, serious disproportions can be observed also with regard to labour. Changes which occurred in the eighties are illustrated in Table 8.

These figures seem to suggest, among other things, that structural adaptation with regard to employment is painfully slow. This is why the Polish economy suffers labour shortages, even though there would have been massive unemployment corresponding to the seriousness of the recession which hit

FIGURE 3: Rate of Consumption and Investment in 1970-1987



Source: As in Figure 1.

Table 8: SECTORAL EMPLOYMENT IN 1985-1990

	Numbers (thousands)		Distribution %		Rate of Growth
	1985	1990	1985	1990	
Total	11,697	12,118	100.0	100.0	3.6
Industry	4,269	4,278	36.5	35.3	0.2
Construction	1,111	1,127	9.5	9.3	1.4
Agriculture	807	824	6.9	6.8	2.1
Forestry	152	170	1.3	1.4	11.6
Transport and Communication	1,041	1,091	8.9	9.0	4.8
Trade	1,252	1,272	10.7	10.5	1.7
Other Material Production & Services	421	448	3.6	3.7	6.5
Total Material Sphere	9,053	9,210	77.4	76.0	1.7
Housing & Non-material Services	211	230	1.8	1.9	9.4
Science & Techno- logical Development	105	145	0.9	1.2	38.1
Education	901	969	7.7	8.0	7.6
Health Care	737	836	6.3	6.9	13.5
Other Non-material Services & Social Organisations	690	727	5.9	6.0	5.4
Total Non-material Sphere	2,644	2,908	22.6	24.0	10.0

Source:*Ministry of Wages, Labour and Welfare.*

Poland in the early eighties, if Poland had been a market economy. It is worthwhile to cite here some comments, which clearly show differences between the crisis and crisis counteraction in socialist and capitalist economies:

*If Poland were a capitalist country in a similar crisis, painful but fairly automatic processes and policy response would be set in motion. There would be hyperinflation, currency devaluation, drastic public expenditure cuts and deflationary taxation measures, tight money, high interest rates, disinvestment, bankruptcies and plant closures, and a couple of million unemployed. Some external creditors would get very little, or nothing at all, following the financial collapse of their debtors; some of the remaining debt would be offset by the sale to foreigners of financial assets (shares, bonds), land, building and plant. Fresh external finance would be available to the more credible borrowers. Unemployment would keep the unions in check, restraining real wages and ensuring labour discipline. The drop in real wage trends and industrial streamlining would eventually promote exports and encourage new investment, attracting foreign capital; **in ten years or so the economy would be getting out of crisis.** (Nuti 1982, p. 47; underlining GWK). The main problem is the fact that in the centrally planned economies there is not an automatic mechanism, which is able to get rid the economy of the crisis.*

Deliberations conducted thus far afford the following conclusions:

First, the Polish economy features a strong dose of inertia, which is reflected in the ability to replicate its crisis-forming proportions, originally established in the fifties and then modified in the seventies, drawing on heavy external financing. Second, the attempt at restructuring the economy, launched in the eighties as a part of the effort to counter the crisis, did not reach deep enough and failed to produce the desired results. Third, the sources of this failure lie both in the lack of an appropriate adjustment programme and in the resistance of certain social and political forces (the steel & coal lobby along with party and administrative bureaucracy and the military complex, all having concurrent economic and political interests) interested in maintaining the current economic structure. Fourth, desirable structural transformations call also for corresponding investment outlays, while Poland's investment potential has been seriously limited, both by the deep recession and Western sanctions imposed following the declaration of martial law in December 1981. Fifth, *no restructuring programme³³ can be successfully implemented without the support of an appropriate economic system (and such system is still lacking in Poland) and of an appropriate state policy (and the state's investment policy in the eighties can be hardly called appropriate).*

³³ And there has been no such extended version in Poland, because neither the 1983-1985 plan, nor that for 1986-1990 can be recognized as such, since they perpetuate the current structure.

These five detailed conclusions afford a certain generalization. The Polish economy is still waiting for a major structural overhaul. It will have to consist in a better subordination of the investment structure and current output structure to world market (which will be helpful with external equilibrium) and domestic requirements (which should facilitate the painstaking process of domestic balancing). The reform of the economy's operation and economic policy must be subordinated to the outline of structural changes drawn above. Only such integral approach to these problems offers hope of achieving the necessary progress.

5. PRIORITIES AND CONSTRAINTS OF ECONOMIC POLICY IN THE PROCESS OF ECONOMIC CHANGES

5.1 External debt

The fundamental problem facing the Polish economy with regard to both short-term stabilization and long-term adjustment to growth challenges is connected with the restoration of the ability to follow a possibly harmonious growth path. This will remain impossible until economic equilibrium is achieved. It is here that we come across the trade-off between the restoration of domestic equilibrium (which is connected to the curbing of inflation) and external equilibrium, calling for restoring equilibrium in current balance of payment. We thus come to the *fundamental question about the priorities, directions, instruments and constraints of stabilization and economic policies in Poland* at the turn of the eighties and nineties.

We can already now formulate the thesis, supported *inter alia* by earlier deliberations, that *apart from the numerous imperfections of the new economic system and economic policy mistakes, the failures of stabilization and adjustment policies in the years 1982-1988 were derived from the impossibility of finding a solution which would simultaneously solve the problems of internal and external equilibrium.*

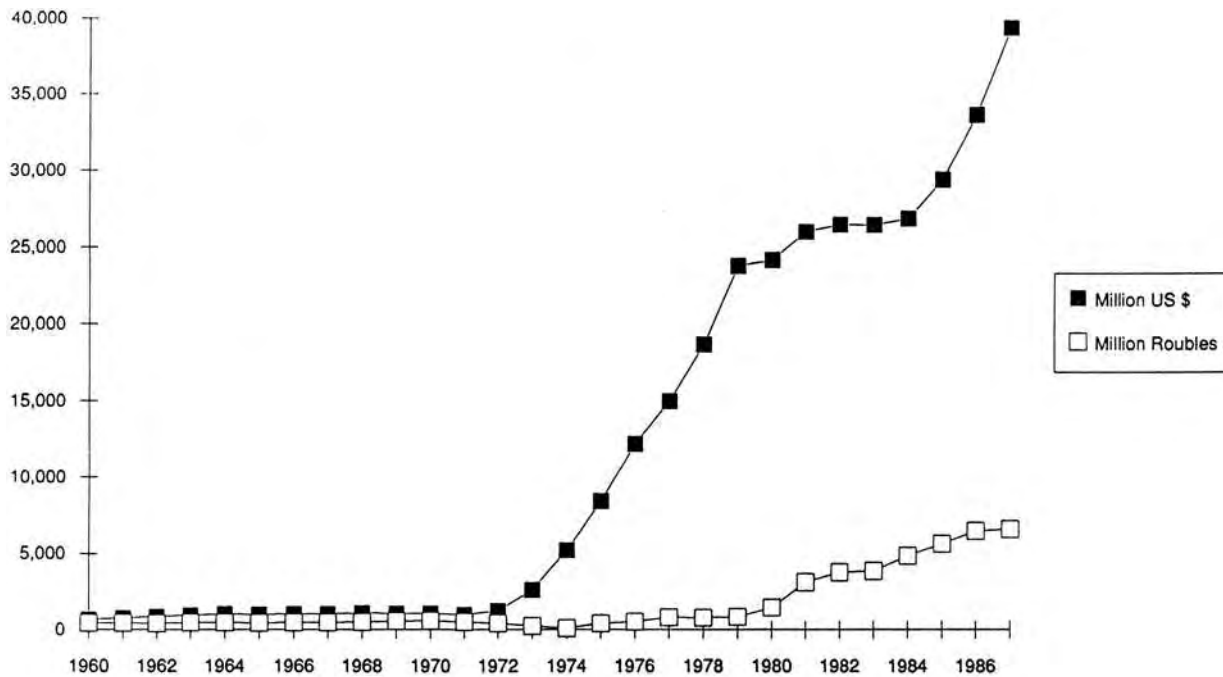
This problem has a number of aspects. As known, the Polish foreign debt is about 40 billion US dollars (the process of the growth of this debt is shown in Table 9 and Figure 4) and about 5.5 billion roubles. In the first case,

Table 9: GROWTH OF FOREIGN DEBT IN CONVERTIBLE CURRENCIES: 1971-1987
(in billion \$)

Year	Balance of Foreign Trade	Gross Debt for End of Year	Net Debt for End of Year	Interests Paid	Amount of Capital Instalments
1971	+0.1	1.3	0.8	0.1	0.3
1972	-0.3	1.7	.	0.1	0.3
1973	-1.3	3.1	.	0.1	0.4
1974	-2.1	5.3	.	0.3	0.6
1975	-2.7	8.4	7.4	0.5	0.9
1976	-2.9	12.1	.	0.7	1.2
1977	-2.2	15.4	13.5	0.9	1.9
1978	-2.0	18.5	17.0	1.2	3.1
1979	-1.7	21.9	21.5	1.7	4.4
1980	-1.0	25.0	24.4	2.5	5.6
1981	-0.1	25.5	24.7	2.3	1.4
1982	+1.4	25.2	24.2	1.9	0.4
1983	+1.4	26.4	25.2	1.6	0.5
1984	+1.5	26.8	25.5	1.3	0.4
1985	+1.1	29.3	28.1	1.0	0.9
1986	+1.1	33.5	32.4	1.2	0.8
1987	+1.1	39.2	37.9	1.0	0.8

Source: *Rocznik Statystyczny Handlu Zagranicznego 1987, (Statistical Yearbook of the Foreign Trade 1987),* Warszawa: GUS, p. 3-6, Białyca (1986), p. 76,77,79,81 and Rutkowski (1988), p.30.

FIGURE 4: Polish Foreign Debt (1960-1987)



Source: National Bank of Poland.

the debt is spread between a dozen-odd Western states, while the rouble debt is almost entirely concentrated in the Soviet Union. Its burden vis-a-vis NNI is illustrated by data in Table 10. Meeting the hard-currency debt service requirements (given an average interest rate of over 8%) would call for an annual transfer of 3.1 billion US dollars abroad. This is equivalent to almost half of the value of Poland's annual hard-currency export earnings and to three times the value of the positive balance between exports and imports (the latter already dramatically curtailed as compared with the pre-crisis period - see Table 11). Assuming that high inward transfers are maintained (1.4 billion US dollars in 1987), such proportions could be achieved, but *at the cost of a further decline in real wages and consumption level at the rate of several per cent annually.* Would that be practicable?

The World Bank and the International Monetary Fund (WB 1987a and 1987b) are proposing Poland a stabilization and adjustment programme which asserts this is both feasible and necessary. One could agree with this position to some extent, if we consider debt service as a paramount priority and assume that numerous Poles working abroad maintain the current high level of transfers to Poland in the coming years. The Polish authorities share the belief that current hard-currency turnover could be balanced under these conditions, maybe already in 1990. Various scenarios with this regard are presented in Table 12.

Table 10: DEFICIT IN FOREIGN TRADE IN ROUBLES: 1970-1987

	1970-75	1976-79	1980	1981	1982	1983	1984	1985	1986	Total 1970-86
in millions of roubles	368	666	763	1611	578	614	668	715	501	6484
in % of NNI			0.9	2.3	0.8	0.7	0.7	0.5	0.5	

Source: As in Table 9.

Table 11: RATE OF GROWTH AND STRUCTURE OF IMPORT AND EXPORT
(by type of countries)

Specification:		1981	1985	1986	1987
in billion of zlotys					
IMPORT					
1	Total	963.4	1594.9	1964.0	2875.6
2	Socialist Countries	529.8	968.4	1193.9	1530.6
3	of which CMEA	498.7	873.9	1027.6	1322.0
4	Other Countries	433.6	626.5	770.1	1345.0
5	Industrialized Countries	357.9	514.4	648.8	1143.8
6	of which EEC	198.6	324.9	418.5	722.2
7	LDCs	75.7	112.1	121.3	201.2
EXPORT					
8	Total	846.2	1691.0	2115.6	3236.5
9	Socialist Countries	410.6	927.2	1140.2	1569.6
10	of which CMEA	387.0	824.5	986.5	352.7
11	Other Countries	435.6	763.8	975.4	1666.9
12	Industrialized Countries	312.6	586.2	717.3	1347.1
13	of which EEC	202.2	391.8	467.7	856.1
14	LDCs	123.0	177.6	258.1	319.8
BALANCE					
15	Total	-117.2	+96.1	+151.6	+360.9
16	Socialist Countries	-119.2	-41.2	-53.7	+39.0
17	of which CMEA	-111.7	-49.4	-41.1	+30.7
18	Other Countries	+2.0	+137.3	+205.3	+321.9
19	Industrialized Countries	-45.3	+71.8	+68.5	+203.3
20	of which EEC	+3.6	+66.9	+49.2	+133.9
21	LDCs	+47.3	+65.5	+136.8	+118.6

Source: *Maly Rocznik Statystyczny 1988*, (Statistical Yearbook 1988),
Warszawa: GUS, p. 241.

Table 12: PROJECTION OF CURRENT BALANCE OF PAYMENT
AND RATE OF ECONOMIC GROWTH (1988 -1991)

	1988	1989	1990	1991
Export	105.0	105.6	106.0	106.5
Import	103.5	104.1	103.6	104.2
National Income Distributed	103.2	103.5	103.3	103.3
of which :				
consumption	103.0	103.0	102.7	102.7
investment	103.9	104.9	104.9	104.9

In millions of roubles; current prices:

Foreign Trade; non-convertible currencies				
Export	11400	11880	12950	13500
Import	10900	11150	11570	12000
Balance	500	730	1380	1500

In millions of dollars; current prices:

Foreign Trade; convertible currencies				
Export	7500	8300	8960	10200
Import	6300	6640	7220	7930
Balance	1200	1660	1740	2270
Current Balance of Payment	-980	-650	-500	+40
Indebtness for the end of year	40060	40680	41510	41810

Source: *Commission of Planning of the Council of Ministers.*

It must be emphasized that this scenario of adjustment to the external determinants would only halt nominal debt growth, at a level equal to 4-year convertible currency export earnings. Internal disequilibrium would at best persist, or become more serious, and not only because of the obvious negative impact of export maximization on the relative curtailment of supply in the domestic market. The relationships are more complex than that.

Pressure on hard currency exports in countries with inconvertible currencies creates additional demand in the internal market. This results not only from income generated in domestic currency in exporting companies, but also from additional, special incentives, typical of the economy of shortage, which must be used to obtain exportable goods.

Under conditions typical for the Polish economy, export maximization contributes to the aggravation of domestic disequilibrium by, *inter alia*, a system of special tax cuts, which are at least partly financed with state budget deficits. This system of financial incentives is nonetheless indispensable, or else there would be no motivation for additional efforts aimed at boosting export production, since the domestic market can absorb nearly anything that is produced.

5.2 External and internal equilibrium: dilemmas and proposals

What we are therefore facing is a peculiar negative feedback, which common wisdom has long ago called the *vicious circle* (Denizet 1977). Attempts aimed at export maximization aggravate internal disequilibrium, while the deeper this disequilibrium is, the more difficult it is to improve the balance of payments. Comes the question: Can these relationships be reversed at all?

It would appear that *at the current stage of the implementation of external and internal stabilization policy, priority ought to be given to internal balancing.* Efforts aimed at increasing exports and its profitability will be more effective, if some major improvement is achieved in domestic equilibrium. Under the present circumstances, 20% to 25% of Polish hard currency exports are unprofitable and require state subsidies, which - of course - have a inflationary effect. The situation with regard to exports payable in inconvertible currencies is similar. An essentially balanced economy would afford a more effective operation of the classic methods aimed at boosting exports, e.g. an active exchange rate policy, stimulating profitable foreign sales.

In the present situation, the systematic devaluation of the Polish currency (see Table 13), which stays ahead of the inflation rate, meaning that devaluation is real, not nominal, provides no effective export incentives as it would in market economies, since nearly everything can be profitably sold in

Table 13:

DEPRECIATION AND DEVALUATION OF POLISH ZLOTY (1981-1988)

		1981	1982	1983	1984	1985	1986	1987	1988
1	Depreciation	17.5	51.1	17.6	12.9	13.1	15.0	20.5	37.5
2	Devaluation	23.7	55.0	13.8	28.3	17.2	33.6	59.7	61.6

Source:

Row 1:

For 1981-1983:

Maly Rocznik Statystyczny 1988, (Statistical Yearbook 1988),

Warszawa: GUS, p.114; for 1984-1987:

International Financial Statistics,

Washington, D.C.: International Monetary Fund, May 1988, p.73; own calculations.

Row 2:

National Bank of Poland; own calculations.

Data for 1988 - own forecast

the domestic market, where demand chronically outstrips supply. Thus, instead of promoting exports, devaluation can only contribute to the persistence of strong inflationary processes and, eventually, counteract export maximization in the long run (Robinson 1971). This does not imply that an active exchange rate policy should not be pursued, but it is supposed to emphasize that such a policy will start bringing effects only when a relatively balanced domestic market will force producers to look abroad for profitable (at a given exchange rate) sales markets.

One must remember that a socialist economy, unlike the market economy of developed capitalism, is constrained by inadequate supply, not demand. This is the source of all bottlenecks, including those involving exports. Hence, checking the level and growth rate of domestic demand should be one of the ways to achieve growth in exports. This appears hardly possible without major improvement in internal equilibrium, with regard to consumer goods in the first place. The achievement of equilibrium should activate some of the elements of economic constraint connected with the reform, also in the form of the *necessity* (and no longer only an opportunity) of seeking sales markets also abroad.

In discussing the trade-off between the rapid achievement of either external or internal equilibrium, one must emphasize certain differences which can be observed in adjustment programmes suggested by the authorities of the countries concerned and those proposed by international financial

organizations. There can be no doubt that there are conflicting interests. The World Bank and the International Monetary Fund view adjustment programmes as a means of ensuring liquidity on the international scale and regular debt service. The governments of the countries concerned - and Poland is no exception in this respect - give priority to the creation of conditions favouring long-term socioeconomic growth through an appropriate level and structure of investment and the best possible fulfilment of social needs, and certainly at least at levels *ensuring internal social and political equilibrium*. Here again we come to the feedbacks between politics and the economy, which cannot be ignored in the analysis of the different scenarios of adjustment policy.

The inflation typical of the economies of reformed European socialist countries³⁴ is partly attributable to the transfer of a part of the GNP abroad. It is particularly clear in the case of Poland and Yugoslavia, and - to a slightly less extent - in Hungary. While stabilization and anti-inflationary programmes proposed in 1982 (Programme 1982) and 1983 (Programme 1983) aspiring to significantly curb inflation in these countries by the mid-eighties, might seem somewhat naive nowadays, one must note that the continuous transfer of a large part of the GNP to the West had to be financed with inflation, since it was politically impossible to lower the nominal level of households' incomes. And inflation, by its very nature, tends to get out of hand. This is why there are

³⁴ On this issue see also Adirim (1983) and Bechtold and Helfer (1987).

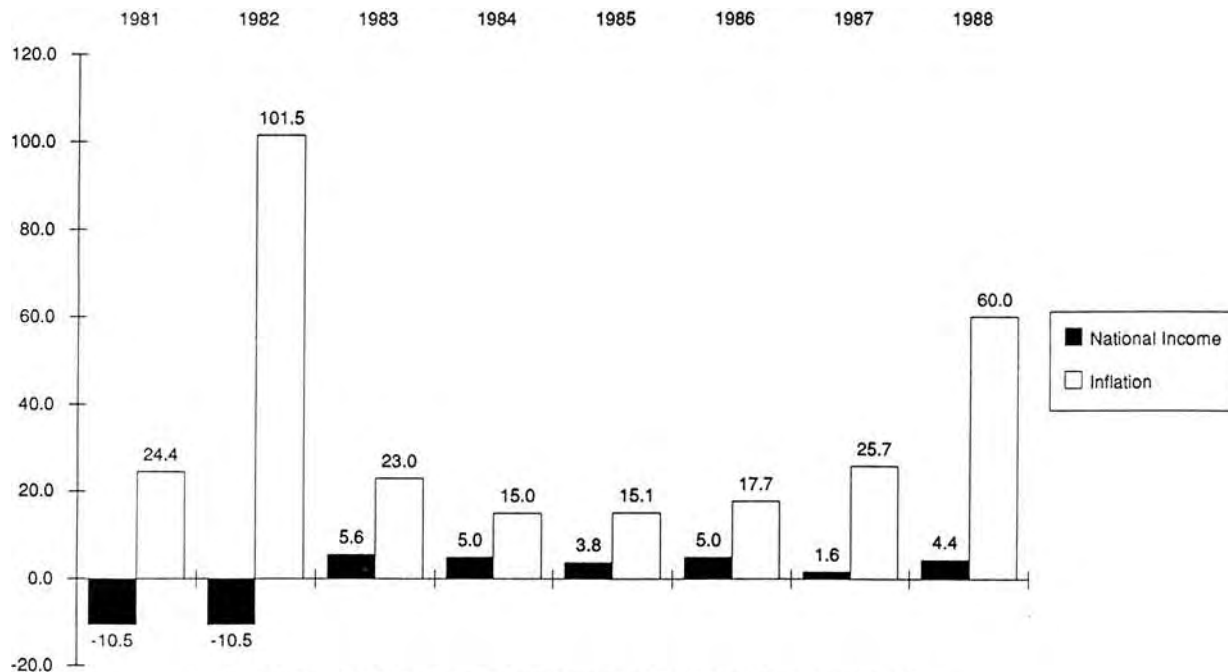
such important differences between the effects assumed in these stabilization programmes and reality³⁵.

Hence, the opinion that the dilemma leading to this discrepancy no longer holds is all the more surprising, since it remains very clear. It would therefore appear that a *near-optimal stabilization programme - given the trade-off between the rapid restoration of either internal or external equilibrium - should be a certain compromise between the interests supported by international financial organizations and those of the population concerned, better or worse represented by the government.*

Drawing on the above comments one could outline the following sequence of events in the implementation of the adjustment policy, which would be best suited given the specific features of the Polish economy at the threshold of the nineties. The stabilization of domestic economic situation must be given top priority, which should find its reflection in a corresponding stabilizing and anti-inflationary programme. This should be accompanied by a market- and export-oriented programme of structural changes. The systemic reform should promote its implementation. Only after the achievement of domestic equilibrium and of a mature, export-oriented structure of the economy, it will be possible to successively regain external equilibrium, without adversely affecting the

³⁵ In the case of Poland it was assumed that the rate of inflation will be one-digit by 1985. As a matter of fact, it was 13% and - what is here more important - has risen during the following years (see Figure 5).

FIGURE 5: Economic Growth and Inflation in Poland (1981-1988)



Source: National Income: as in Figure 1. Rate of Inflation: International Financial Statistics, Washington, D.C.: International Monetary Fund, July 1988, p.73. Data for 1988: own forecast.

domestic situation. The recovery of external equilibrium will be first expressed in balanced current account of payment and, in the second stage, in the absolute reduction of nominal foreign debt.

The above comments were formulated with regard to Poland's indebtedness to the West, but their essence applies also to Poland's debt in the Soviet Union. Debt service on the latter, however, is very much less of a burden, in view of both its scale, interest rate (about 5% p.a.) and - most of all - of its proportion to the nearly double value of exports in roubles and with respect to the national income (see Table 10). The state of Polish - Soviet relations is another meaningful element here.

It is worthwhile to mention also, that unlike the hard currency debt, which had exceeded 20 billion US dollars already by 1980 (and doubled in the eighties due to high interest rates), Poland's rouble debt soared only after 1980, in part due to the unfavourable pricing system with the CMEA. This system consisted in the annual fixing prices on the basis of the moving average of world prices over the past 5 years. Given the structure of Polish - Soviet trade, especially the importance of coal and oil,³⁶ Poland suffered some definite losses (Rutkowski 1988), which might be renegotiable in the current favourable political climate.

³⁶ On the implications of the fluctuations of the oil price for the inter-CMEA trade see Nikitin (1981) and Shmeliiov (1983).

Coming back to the hard-currency debt, it appears that Poland will not be able to cope with debt service, if high interest rates are maintained. Poland is already so deep in the *debt trap*, that having paid some 35 billion dollars of principal and interest over the past dozen-odd years, it still owes about 40 billion to its creditors. The situation in Yugoslavia and Hungary, not to mention the LDC's, is similar. This problem is no doubt waiting for a more general - maybe global - solution.

6. **SHORTAGEFLATION DILEMMA AND ITS IMPLICATIONS FOR ECONOMIC STABILIZATION AND ADJUSTMENT**

6.1 **Price distortions**

The level and structure of prices are the fundamental problem involved in the stabilization and adjustment processes in the Polish economy, with regard to both the control sphere (economic and financial mechanism) and economic policy. Owing to rampant inflation, prices have soared almost ten-fold over the eighties. The level of prices in 1988 is equal to over 930% of the level from 1980.

Figures shown in Table 1 prove, that despite prices which soared at one of the highest rates in Europe, their structure remained essentially unchanged. It is for this reason, given the persistence of internal disequilibrium, that the Polish inflation is often described as 'idle', since it does not bring any desirable effects. What makes this opinion justified, is the fact that, unlike Poland, Yugoslavia has used its rampant inflation of the eighties to establish certain elements of the buyer's market and that the proportions of domestic prices for the main product groups resemble those in the world market, the exchange rate is near the real equilibrium rate, while subsidies for unprofitable products account for a mere 1.5% - 2.0% of the GNP. Neither of these goals had been achieved in Poland.

The current level and structure of prices in Poland (and in other socialist countries) are by no means accidental. They are the outcome of a definite way of the economy's operation and of well-defined economic policies, designed to maintain

low prices (through subsidies) for staple consumer products. At the same time, goods other than life's necessities were priced relatively high comparing to other products and to the purchasing power of average wages. Thus came about a price structure which is even farther away from that of social production costs. Ties between actual production costs and the market prices have been severed. What is expensive to produce need not be expensive in the market and conversely.

Such a status quo cannot be maintained if market reform are to be implemented. Prices must in the long-run reflect value proportions. It is precisely where the recent Polish price reforms are heading, both with regard to pricing mechanisms and the underlying policy. Attempts designed to make prices dependent on value obviously call for major cutbacks in state subsidies and grants. Cutting back on subsidising will in some cases lead to the elimination (which is very rare) of unprofitable products and in others will be automatically compensated by higher prices. However, the relationships between prices, incomes, supply and demand which have established themselves over the years are such, that the *prices based on the social costs do not correspond to prices based on scarcity (i.e. supply-demand balance)*. This dichotomy points to one of the central problems involved in the shaping of a price structure required in an efficient market mechanism. It also points to the source of the failures of all major price operations attempted in Poland in the eighties.

These operations were bound to fail, because:

- first, they emphasized cutbacks in subsidies or their wholesale elimination, which involved greater price hikes with regard to goods where disequilibrium was least painful (e.g. food market in Poland in 1988, housing services or urban transport);
- second, increases in the prices of scarce higher quality goods were inadequate for balancing requirements;
- third, the structure of households' expenditure extorted wage rises and the growth of other households' incomes, which usually more than compensated the growing cost of living. Except the 1982 operation, when prices shot up by more than 100%, no other price operation had achieved the desirable deflationary effects.

6.2 Trade-off: price inflation versus shortage

These observations lead us to formulate the *shortageflation dilemma*, which presents clear-cut options of adjustment policy with regard to prices. The dilemma comes down to the trade-off between the shortage rate in the socialist economy and the scale of price inflation. The existence of this trade-off at least in the short-term, seems to be apparent (Kolodko and McMahon 1987), though not all authors agree (Kornai 1982, Nuti 1986, Pawilno-Pacewicz 1986).

One can observe certain similitudes between the *shortageflation dilemma* in the socialist economy, and the relationship depicted by the *Phillips curve* for the market economy. While in the first case we are facing the

alternative: a higher rate of price (open) inflation or greater shortages (a higher rate of repressed inflation), in the second case the issue concerns stagflation and the alternative is: higher unemployment or a lower inflation rate, and conversely.

In the long term the shortageflation syndrome appears in a slightly different light. There is evidence from reformed socialist economies in the eighties, including Poland which once again is the most vivid example, that whatever the price level, shortages recur, except that it happens at ever higher price levels. Naturally, firms' incomes and expenses, as well as the manufacturing costs, are rising in similar proportions. This is therefore the replication of Kornai's *normal shortage*, while the scale of shortages in the economy may be a little more or less acute, depending on a number of other constraints. Such a replication of shortage, independent from the scale of price hikes, is made possible by systemic determinants in the form of soft budget constraints and soft financing.

One can concede that the situation presented above has been the usual practice. It does not, however, imply the inevitability of such developments. It appears, that given changes now occurring in the economic system in connection with economic reform and with the reorientation of priorities in economic policy due, among other things, to the pressure of international financial organizations, the socialist economies (including Poland) are turning to tighter money policies and

related budget constraints. If it is really so, then stabilization policy in the long term is also faced with the trade-off: higher prices inflation against deeper disequilibrium and conversely.

Naturally, there is more to the shortage versus inflation trade-off than just the price aspect. It must be emphasized here, that *no adjustment programme or stabilization policy can be expected to succeed, unless accompanied by increased supply in the real terms*. Hence, the *shortageinflation dilemma* should be viewed in a broader context, that is against the background of market (in the sense of the maximization of products bought by the households) and export-oriented transformations in the areas of investment and production.

Price adjustment policies pursued heretofore in Poland promoted the replication of shortages irrespectively of price hikes, precisely because they were designed to align prices on value rather than scarcity (market) relations. Hence, the shortages were nearly automatically replicated, because price rises affected relatively abundant goods (or more precisely those in relation to which shortages were least acute), while price growth for goods, which were essential for the supply-demand balance in the domestic market, was too slow.

The problem of shortageinflation has two aspects: short- and long-term. In the first case, any strategies must be founded on the choice of price (open) inflation, as the proverbial 'lesser evil', because this will favour the

limitation of shortages in the short term. In the long-term however, anti-inflationary strategies will precisely for this reason demand, that there be a *simultaneous* shift of the shortageflation curve to the left and up,³⁷ and also moving to the curves lying closer to the beginning of the system of coordinates. Such a strategy is shown in Figure 6 by moving from point A through B to C. Hence, the point is to *diminish the size of the inflationary gap ex ante* through the appropriate steering of supply and demand, on the one hand, and to bridge it using price growth, on the other.

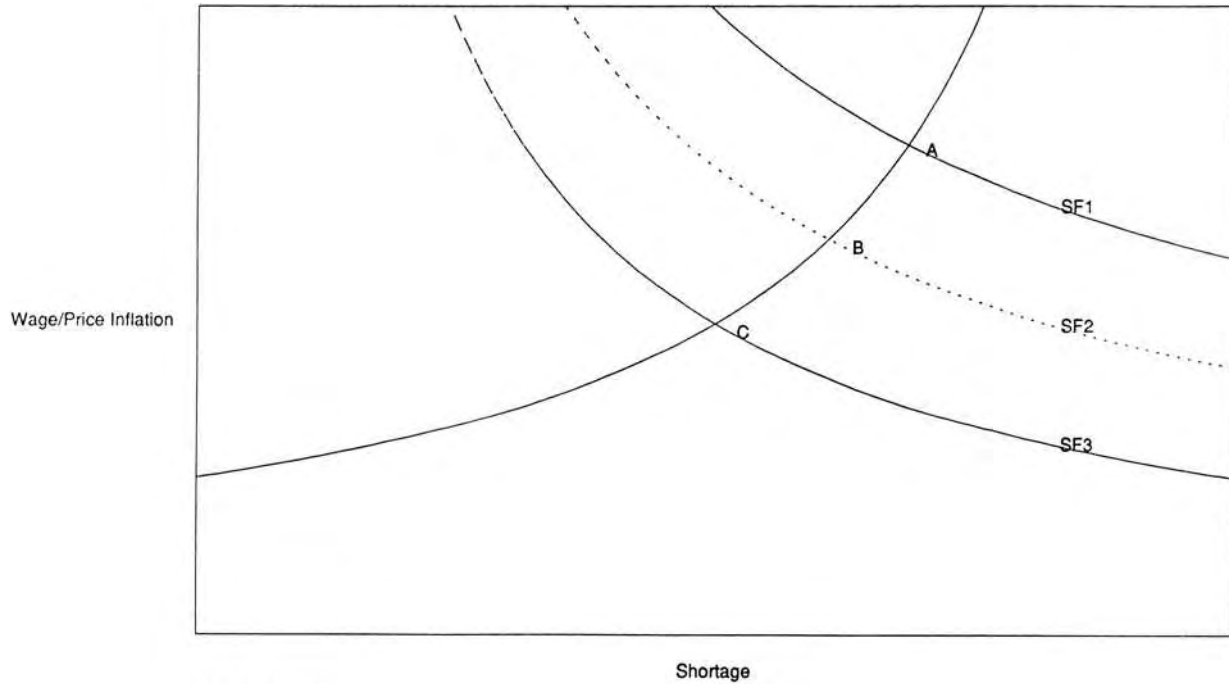
The thesis presented above means that *the only adjustment policy scenarios which are politically practicable (meaning that their implementation makes sense) are those which ensure a parallel diminution of both the rate of price (open) and repressed (shortage) inflation.*

6.3 Uninstitutionalized public debt

The problem of forced savings accumulated in earlier periods, referred to as the *inflationary overhang* (Kolodko 1986a, Nuti 1986), is an additional complication in the handling of contradictions involved in the shortageflation syndrome. This phenomenon makes stabilization and anti-inflationary policies even more difficult, because they involve not only the balancing of demand financed by current incomes with the supply, but also the balancing of a money

³⁷ Which implies that bridging the inflationary gap mostly by rapid inflationary price growth, rather than by other means, such as the transfer of a part of the unsatisfied demand to the 'second economy' (Cassel 1985) or the growth of forced households' savings.

FIGURE 6: The Shortageflation Dilemma: A Dynamic Presentation



Source: Author.

supply, which the households were forced to withhold from the market (Oles, Pawilro-Pacewicz and Sumlinski 1987).

This excess demand created by earlier accumulated money, added to that created by current incomes (at a given level of the propensity to save), is putting a heavy strain on the Polish consumer market, considerably hindering its equilibration, especially with regard to the fragmentary markets of consumer durables, where deferred demand is particularly heavy owing to major shortages.

The inflationary overhang boosts households' *inflation expectations*, which further increases shortages and/or price inflation. Recently such a cumulative process could be observed in the fall of 1987, when the government submitted the project of stabilization measures included in the earlier mentioned blueprint of the second stage of economic reform under discussion. The public sentiment was that major price hikes (including a 110% rise in the prices of staple foods and an average increase of the overall price level by about 60%³⁸) were its central point.

It is obvious, on the one hand, that the inflationary overhang, which is a peculiar form of *uninstitutionalized public debt*, cannot be drained with inflationary price increases. On the other hand, there is no doubt that inflation does contribute to reducing its real volume, because the

³⁸ As a matter of fact, the rate of inflation in 1988 is close to 60%, and so is the price rise of food. Hence, there will be hardly any significant change in the structure of the prices.

overhang is partly held in cash and on demand deposits (so-called 'hot money') and partly on savings deposits. But these deposits earn interest rates which in 1988 averaged less than half of the inflation rate.

The situation can be brought under control through a *gradual neutralization of the inflationary overhang*. This should consist in the balancing of demand derived from current incomes with the supply. Then, following progress in the stabilization of the overall economic situation and less acute shortages, combined with a falling inflation rate plus the parallel introduction of positive interest rates on bank deposits, households' *inflationary expectations* should be lower. This in turn, should increase the propensity to save, finding its reflection, among other things, in the transformation of forced (meaning that on the macroeconomic scale this money cannot be spent) into voluntary savings. Hence, the economy's capacity to accumulate would be enhanced. Supply effects, which should gradually become visible, should further stimulate the positive growth trends thus initiated.

7. PROSPECTS FOR ECONOMIC DEVELOPMENT: ALTERNATIVE SCENARIOS

7.1 Continuation or acceleration?

When alternative scenarios of economic, social and political developments are outlined, there usually is a presentation of the extreme options and certain middle-of-the-road variants. Life shows that it is the latter which are most frequently implemented. There are two such extreme options for Poland. First, the return to the centralized, bureaucratized management system of the national economy, with the dominant position of directively-distributive planning and a corresponding institutional system, adequate to the hierarchical economic structure. Second, a rapid and complete alignment of economic relations on the market, structural transformations which would completely draw the national economy into the international division of labour, a strong limitation of the state's economic role and a far-reaching re-privatization of the means of production.

It can be expected that once again life will keep to the middle-of-the-road path, for there are no political forces in Poland capable of enforcing either of the extreme options. Adjustment processes in the systemic, structural and political spheres have gone too far, for a simple return to the *status quo ante* to be possible. Also, for the first time in the history of reforming efforts, there is a favourable external climate, which is connected with Soviet reformatory efforts.

The second extreme scenario is equally unlikely, and for the very same reasons: because once again, contrarily to many conjectures, popular especially in the West, there are no sociopolitical forces which would back such changes.

Actually, growth alternatives are both quite clear and limited. I believe two general scenarios can be discussed: continuation and acceleration. There is not really a way back. The scenario of continuation will consist in the preservation of the heretofore character and pace - relatively low and unsatisfactory - of the changes. It applies to all three planes analysed here: systemic changes (economic reform), structural transformations and changes in economic policy (and also politics in general).

I have emphasized before, that for all the critical evaluations, *far-reaching changes have been introduced in the Polish economy in the eighties*. Politicians usually stress this aspect, taking the initial state as the point of reference. This point of reference in Poland's case is the state of the economy at the turn of the seventies. Economists usually view the process of changes through their expectations and concepts - more or less mature - with regard to the target (or desirable) model. Evaluations must differ, given such differing viewpoints concerning the scale of progress (or of its lack). International financial organizations, other non-governmental organizations and the scholars and politicians from the market economies take a still different approach to the scope of changes; the latter look at changes in the

socialist countries against the background of the operation of their own economies.

Nonetheless, changes which have taken place in the Polish economy are hardly satisfactory. Hence, the *scenario of continuation should be viewed as pessimistic*. It would imply, among other things, a slow evolution of the existing industrial capacities, with a dominant role of heavy industries, characterized by low competitiveness in world markets and a low capacity to meet internal demand, especially with regard to consumer goods. Such a structure will continue to support strong inflationary tendencies. Parallel to that, insufficiently radical and superficial changes in the control sphere will additionally strengthen inflationary trends and disequilibrium. Given these slow and superficial systemic changes yielding no major structural transformations, the state's economic policy will remain soft, which will be reflected in yielding to the pressure of politically strongest groups rather than to the most efficient in economic terms.

It is obvious that the implementation of this scenario will involve growth in the macroeconomic categories³⁹ (NNI, investment, consumption, foreign trade turnover), but they will be accompanied by a strong inflationary redistribution of national income and wealth, a relative structural stagnation, high material and energy intensities, insignificant involvement in the international division of labour and other

³⁹ See the forecast for economic growth in Poland up to 1991 presented in Table 12.

features connected with an efficiency lower than that of the market economies.

The scenario of continuation, with greater or smaller changes, periodical accelerations and subsequent slow-downs of adjustment processes, does not imply stagnation in the systemic and structural sense, or with regard to output or consumption levels. It would however, constitute a certain *relative stagnation* in the sense that the economy would be unable to even start breaching the gap separating it from the more advanced countries.

The second scenario considered here has been named as a *variant of continuation*. What is characteristic for the present stage of reforms in all socialist countries which are actually implementing them, is that in all these countries *there is a need to accelerate the adjustment processes*, otherwise the effects of the efforts made thus far may be lost. Such acceleration, or at least the attempts to do it, can be observed in Hungary, Poland, Yugoslavia and the Soviet Union. In all these cases we witness pertinent political declarations, but also concrete action programmes are drawn up. In Hungary, for example, there is the new, Grosz's (A Minisztertanács 1987) stabilization programme, in Yugoslavia there is also a new stabilizing and anti-inflationary programme (Programme 1987).

In Poland these attempts at acceleration have found their reflection, among other things, in the revision of the current

five-year plan for the years 1986-1990 with regard to the investment programme. It is best reflected in the enforcement programme of the second stage of economic reform. This programme emphasizes the pressing need to balance the national economy, to introduce money and capital markets, to allow more competition and a more widespread use of the mechanisms of economic constraint, to open up the economy to the outside world and to gradually achieve currency convertibility, first within the national economy (internally), then within the CMEA and eventually complete convertibility, to further decentralize economic management and to diversify the forms of ownership, including a widespread use of joint-stock companies, joint ventures, etc.

The revision of the investment programme inscribed in the five year plan applies to the long demanded, both by the Polish economists and the World Bank and the International Monetary Fund, curtailment of outlays on the further expansion of mining, steelmaking and shipbuilding industries, and their allocation to an accelerated development of processing industries, mainly to boost exportable production and the supply of consumer goods.

7.2 Economics and politics of acceleration

Certain elements of the implementation of the acceleration scenario can be observed also in the third plane of adjustment and stabilization measures, namely with regard to economic policy. Progress in this area is still inadequate,

but it would appear that a certain tightening up can be observed, without which it will not be possible to implement the programme of accelerated structural and systemic changes. Hence, we see once again, that the implementation of the scenario of an accelerated adjustment programme is possible *only when this acceleration involves all the three planes: systemic, structural and political.*

What is characteristic of these adjustment programmes in Poland (but also in Hungary and Yugoslavia), is the conviction maturing among the politicians responsible for their implementation, that *no qualitative changes in the economy are possible without simultaneous changes in the area of political relations.* This is why so much importance is attached to the processes of democratization which accompany economic changes. One can say that both these processes rely on each other for their success, that progress in one of them furthers progress in the other and, what must be stressed, the inverse is also true. The ever stronger feedback between the economy and politics must be recognized as a symptom of the acceleration of changes.

Let us now revert to the determinants of the success of the economic reform and accompanying economic changes, mentioned in section 3. We come to the question about the evaluation of these factors in the aspect of the likelihood of either the scenario of continuation or acceleration coming true. It appears that there are two factors which have a particularly negative impact on the realization of the

acceleration scenario. First, the population is unwilling to bear the inevitable costs involved in the implementation of the adjustment programme. Second, there are practically no reserves (actually, there is the opposite of reserves, that is our enormous external debt) which would allow the margin of freedom necessary in the economic manoeuvre and facilitate the passage of the most difficult stage without social disturbances.

As goes for the first element (social consciousness), it must be stressed that the Polish population is already tired with both the crisis and reform. The population associates reform with the most painful of its symptoms - price hikes. Inflation which accompanies reform entails an important redistribution of incomes which produced a situation, where despite the growth of the average consumption level, many social groups and households have been suffering a systematic decline in their consumption for several consecutive years. It is for these reasons that many households prefer, for example, meat rationing than more realistic pricing, i.e. meat prices increased to a level which would balance supply and demand. It must be emphasized that under the conditions of disequilibrium, typical of the Polish economy, an increase in the prices would not be equivalent to the lowering of the average consumption level, but to a redistribution of incomes.⁴⁰

⁴⁰ For instance, the real wage has decreased in 1987 - according to official data - by 3.7 % on average, while the consumption (in fixed prices) has went up by 2.0 %.

And as long politically sensitive groups remain unwilling to accept such redistribution - required for the introduction of market mechanisms - this will remain an objective barrier in the implementation of changes, which would thus be only economically rational. One must remember, that it is *not* rationality or theoretical correctness that makes any given system or adjustment programme enforceable, but the actual balance of social and political forces interested in the implementation of particular changes. This balance in Poland is still unfavourable, which further enhances the importance of appropriate economic policy, capable of changing - though only in the long term - the social attitudes. However, what will really count in the end, will be the material effects of these changes.

In this light we must once again raise the issue of the external adjustment of the Polish economy. It is obvious that this objective should be viewed in the long term and in the light of the creation of the reserves necessary to safeguard the implementation of the acceleration scenario. We have demonstrated earlier, that internal stabilization will in the long run favour also the external balancing. We may therefore conclude that the realization of the acceleration scenario will not be possible *unless the debt loop is loosened*.

This is why Poland attaches so much importance to collaboration with the World Bank and the International Monetary Fund in connection with the implementation of its programme of economic stabilization and structural adjustment.

These organizations can, on the one hand, provide assistance in the programming of the necessary adjustment measures and, on the other, supply financial backing. And unless such backing is secured, even the scenario we defined as one of *continuation* may prove too optimistic.

It must be emphasized in addition to these comments, that external support for the process of economic changes in Poland can only have a complementary meaning. The success of these changes is conditional upon determination in the internal policy and the population's willingness to carry out the proposed reforms. Moreover, external assistance makes sense only when there is hope that it will be properly used. This can be guaranteed only by internal reforms, especially with regard to economic and financial mechanisms, and to the instruments and directions of economic policy.

8. CONCLUSIONS

Deliberations presented thus far clearly show that adjustment and stabilizing efforts - in the socialist economy in general and in Poland particularly - have their own specificity, which distinguishes them from stabilization policies typical for developed market economies. It is derived from economic relations shaped over the years, founded on hierarchical central planning and a relatively passive role of money and market relations, with all institutional solutions proper to market relations (with regard to both the economy and non-economic public institutions), and from the existing economic structure. Thus, many stabilizing measures which can be considered as classic, like tight money policies, are not always applicable to reformed socialist economies. First a state of relative equilibrium must be achieved and only later attempts can be made to change the principles of its performance with the use of the well-known market instruments.

The above statement is hardly meant to suggest that we should wait for better times before reaching more extensively towards the market mechanism. We have already had the better times. The problem is that even under conditions much more favourable to reforms (e.g. in Poland in the early seventies), there was no sufficient leverage behind the necessary economic changes. Now these changes must be implemented, but under particularly adverse conditions. The general direction of changes undertaken in the socialist countries - which includes Poland since 1981 - drives at the marketization of economic

relations, but only at a pace which is practicable in view of economic disequilibrium. A more radical use of market instruments could result in the loss of control over the economic and social situation, which would entail higher inflation and the consolidation of the phenomena which accompany the economic crisis. *The fine art of stabilization policies and adjustment programmes under these conditions must consist in striking the balance between economic necessity and political feasibility.*

The Polish crisis and the stabilization measures it involves are nothing unique in the conditions of socialist economy; other centrally planned economies are facing similar problems. Polish specificity, seen against this background, consists rather in the extent and seriousness of the crisis. This is why there are cases when certain measures must be more far-reaching and focused on the achievement of economic equilibrium in all areas. Below are listed some of the measures required with this respect, including the instruments of their implementation and the possible effects (Table 14).

The consistent implementation of such measures should accelerate the restoration of equilibrium in the Polish economy. This in turn, as has been frequently stressed before, will favour economic efficiency. *The less disequilibrium there is, the easier it will be to implement the market systemic reform, the deeper will be the market- and export*

Table 14: STABILIZING MEASURES IN THE POLISH ECONOMY

Specification 1	Instruments & Methods of Implementation 2	Anticipated Effects 3
Balancing of the state budget.	Cutting back on grants & subsidies for unprofitable production, by shutting down unprofitable firms and through the alignment of prices on manufacturing costs. Increased taxation of the households through the imposition of wage taxation and the value added tax, to supersede the turnover tax.	Lower budget expenditure. Higher budget incomes. A balanced state budget, limitation of inflationary pressure and of counter-productive redistribution.
Balancing of the consumer goods' market.	Supply maximization through support for enterprise, small-scale private business, market-aligned shifts in the investment and production structure, financial preferences Limitation of the growth rate of domestic demand through inflationary (indirect taxation and price increases) and deflationary (checking the growth of firms and households' nominal incomes and government expenditure) instruments. Increasing the propensity to save by, inter alia, creation of a capital market, opportunities to buy shares and bonds, institutionalization of public debt, more realistic interest rates on bank deposits.	Less dramatic shortage-flatio dilemma. Lower price and wage inflation rates. Maturing premises of economic constraint, price rationalization, increased competition favouring efficiency. Limitation of the "second economy". Streamlining of incentive systems.
Balancing of the labour market.	Less state paternalism. More widespread use of economic constraint.	Reduced latent unemployment and counterproductive labour shortages.
Balancing of current account of payment.	Export maximization through a more realistic exchange rate, financial preferences for exporters, creation of joint-ventures with foreign capital. Maximization of inward transfers. Rationalization of import spending. Unconventional foreign debt management methods (swaps and suchlike).	Faster growing export earnings, especially in hard currencies. Positive trade balance. Stabilization of nominal foreign debt and then its gradual reduction.

Source:

Author.

-oriented structural transformations and the more efficient will be the state's policy support for these changes.

The directions of stabilization and adjustment measures outlined above are already undergoing practical implementation, though to a varying extent. It would appear that the lack of comprehensiveness and inconsistency, on the one hand, and inadequate consideration paid to the mutual relationships between the systemic, structural and political spheres, on the other, have been the main drawbacks of these undertakings thus far. Now there seems to be a chance for such a comprehensive approach to broadly understood stabilization policies in Poland, which offers hope for the overcoming of the crisis which the Polish economy has been living for a number of years and for embarking on a path to relatively normal socioeconomic growth. There should be no illusions, however, that this process will be easy and devoid of conflicts. The necessary stabilization and adjustment measures do have a price, but the sooner it is paid, the sooner the indispensable radical measures are taken, the lower this cost will be.

LIST OF TABLES

1. Rate of Inflation in Poland (1980-1987)	26
2. Real Income of Household Sector (1980-1987)	28
3. Economic Growth in Poland: 1983-1988	34
4. Main Economic Indicators in Poland	36
5. Growth and Structure of National Income in Poland	74
6. Poland's Foreign Trade: 1971-1987	76
7. Structure and Rate of Growth of Investment: 1971-1990	77
8. Sectoral Employment in 1985-1990	80
9. Growth of Foreign Debt in Convertible Currencies: 1971-1987	85
10. Deficit in Foreign Trade in Roubles: 1970-1987	88
11. Rate of Growth and Structure of Import and Export (by type of countries)	89
12. Projection of Current Balance of Payment and Rate of Economic Growth (1988-1991)	90
13. Depreciation and Devaluation of Polish Zloty (1981-1988)	93
14. Stabilizing Measures in the Polish Economy	120

LIST OF FIGURES

1. Economic Growth in Poland (1950-1988)	2
2. Economic Growth and Money in Poland (1981-1988)	69
3. Rate of Consumption and Investment in 1970-1987	79
4. Polish Foreign Debt (1960-1987)	86
5. Economic Growth and Inflation in Poland (1981-1988)	97
6. The Shortagflation Dilemma: A Dynamic Presentation	106

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