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The author reviews the determinants and barriers to a faster overhaul of the socialist economy. It is suffering from a deep, general crisis, which can be cured only through a systemic, market reform, a restructuring of the real sphere and a realignment of economic policies. Shortageflation and foreign debt pose the most difficult challenges, seriously limiting room for manoeuvre to improve economic efficiency.

Another issue discussed here are the necessary changes in the consumption and real wage levels, as the cost of stabilisation measures. The author proves that stabilisation calls for at least a transitional stagnation in real wages. However, under the conditions of an economy of shortage, it is not tantamount to the stabilisation of consumption. Actually, in the deep disequilibrium of an economy of shortage, consumption may grow even when the absolute level of real wages is somewhat lowered.

In the final part of this essay, the author considers various scenarios of further developments in the socialist countries of Europe, in the aspect of EEC integration after the year 1992. The latter has some very definite implications for the whole of stabilisation policies in the short term and for adjustment - in the longer run - in the face of changing domestic and external growth challenges.

1. Introduction

Years spent on trying to stabilise the economy have failed to produce results and the process of macroeconomic reproduction is still suffering from a crisis. While the scale may differ from country to country, this statement is true for Poland, as well as for other socialist countries. This crisis, which I call the general crisis of the socialist economy to differentiate from the production crisis, consisting in the decline of the absolute output level, as was the case in Poland in the years 1979-82, is reflected in many negative phenomena and social and economic processes. Specifically, I refer to slower economic growth /or even recession, sometimes/, structural stagnation, disequilibrium and inflation, foreign debt, low competitiveness, lack of innovative propensity and ecological disequilibrium. Problems resulting therefrom are the fundamental growth challenges that contemporary socialist economies have to deal with.

Looking at the phenomenon of the general crisis of the socialist economy, one must perceive its three dimensions: systemic, political and structural. Attempts to implement radical and irreversible changes in the economic and financial mechanisms, i.e. the economic reform, are a reaction to the systemic crisis. Measures taken to counter crisis phenomena in the area of economic policy are reflected in a new evaluation of the objectives and recourse to instruments and methods different from those which had been previously used. It is precisely in this light that one should consider the stabilisation policy. The new, reformed economic and financial system, and the new economic policy which should support its operation, should lead to such transformations in the real sphere of the national economy, which would produce an economic structure geared to social needs and - especially - to effective demand. This means that the restructuring of the national economy should be perceived a reaction to the deep and still persisting structural crisis.

Thus, stabilisation policy should be viewed as a part of a broader social and economic policy. It is so, because we have a seriously destabilised economic system /but also a destabilised social and political system, which is largely a result of the former/, where there are various interferences in the course of growth processes. This is why, keeping in mind the need for measures designed to achieve long-range economic and social effects, especially to ensure the best possible fulfilment of social needs and the creation of stable and durable premises for future growth, it is still necessary to implement appropriate short- and medium-term measures intended to stabilise the economy. This usually refers to steps taken to balance the economic system, both with regard to the external environment and - which is more important - internally.

At the present stage, the priorities of stabilisation policy in the socialist economies are connected mostly with growing foreign debt and ever higher inflation. There are broad implications to that, as the problem concerns both forms of inflation /open and repressed/, as well as financial disequilibrium, un-institutionalized internal debt in the form of the inflationary overhang, the second economy, the parallel existence of two currencies and other related phenomena. There are some definite relationships between all these issues, though some of them are actually contradictions.

2. Attempted Acceleration

The late eighties brought a marked acceleration of the necessary adjustment processes in several socialist countries. It could be observed in the systemic, structural and political spheres, though changes were slowest with regard to structure, largely due to the nature of structural changes, which require investment outlays, among other things, while the crisis restricted the ability socialist economies have had in the earlier stages of their development - that of a strong investment drive. Structural changes within a given structure of productive assets are relatively insiqnificant, which is derived from insufficient systemic or political pressure on such transformations. I specifically refer to the conversion of a part of the productive capacities from the manufacture of the means of production to that of consumer products, that is to the curbing of the phenomenon of the so-called "self-eating economy", where a high proportion of the output is consumed for production purposes, and to convert a part of the productive capacities from military to consumer needs, especially to the production of consumer goods bought by the households. Certain symptoms of improvement with this respect could have been observed in Hungary, where it was announced that defense expenditure would be cut by about 14% and in Poland, where these cuts are to amount to about 4% in 1989 /in real terms/ .Major efforts aiming to speed up systemic and political changes were to be observed in the late eighties in Poland, Hungary and Yugoslavia. Generalizing, one may say that their main objective was to continue the likening of these economies to the market economies, a further monetization of economic relations and a democratization of political relations. These three countries saw their governments change, which was followed by more sweeping attempts at the transformation of the economic and financial mechanisms, as well as of the political institutions. Each of them has its own specificity /Adam 1989/, but the processes they are currently undergoing reflect certain general patterns of the contemporary socialist economy and must be seen in the context of the general crisis of socialism in its forms known thus far /often referred to as post-stalinist, though this phenomenon does not apply to Yugoslavia/.

Changing the economy to a market-type, under the conditions of the current crisis, is a far more difficult task than would have been in times of a relatively stable and less unbalanced growth, e.g. in the early seventies in Poland. At that time however, Poland did not meet all the requirements needed to implement such reforms /Kołodko 1988b/.

Looking at this issue from a different point of view, one may observe that it is Czechoslovakia and the GDR - which are economically most advanced and enjoy the highest consumption levels amongst the socialist countries, negligible price inflation and relatively least serious shortages - that have the best economic conditions for the successful implementation of such reforms as are now carried out in Poland and Hungary. The problem however, is precisely that such favourable /in comparison with other socialist countries/ conditions are not what generates reform-minded determination on the part of the authorities, nor do they induce the population to demand reforms /Nick 1989/; the more so that the experiences of the countries which tried to accelerate the process of market and democratic reforms have not always been particularly encouraging, particularly if we look only at the outward appearances - mostly inflation accompanied by social and political destabilisation.

Going ahead with market reforms in the economic and financial system calls for simultaneous progress in the democratization of the institutions of social and political life. This thesis is not only gaining increasingly widespread recognition in the countries which press on with their reforms, but it is also being practically implemented, though to a still inadequate extent. Where does the need to democratize political life come from? The point in not only that it is a value on its own, a value even superior to the economy, but also, a definite historical and international context in which these developments are taking place. After all, the world is advancing at an astonishing pace, also with regard to political evolution.

Another point is that the authorities wishing to carry out their projects of market reforms and implement the necessary stabilisation and adjustment processes, must enforce various unpopular measures over a short period of time. These may consist in the temporary lowering of the living standards of some social groups, liquidation of loss-making companies or even whole industries, changes in the structure of prices and incomes, an overhaul of the tax system producing far reaching consequences in income redistribution, etc. We thus come to conflicting economic interests, in many complex planes, without being wholly aware of the directions and even less, of the intensity of redistribution in incomes and wealth. If wrong methods are used, or if the timing is wrong, these contradictions may be further antagonized, as vividly illustrated by the Polish crisis of the eighties.

Thus, the implementation of such unpopular, sometimes potentially antagonizing measures, designed to streamline the economic system and economic structure, may call for the canvassing of popular support. The authorities must secure at least the passive approval of various social and political forces which are beyond their control, for their stabilisation policies. As it is known, implementing the necessary changes requires a strong government. One may say that the more sweeping the systemic and structural changes undertaken in the therapy of short-term stabilisation and long-term adjustment, the stronger the government must be.

The strength of a government may be derived either from popular support or from efficient policing. Market reforms and democratization require the former. It is in this light that we should view the political transformations in some of the socialist countries, especially in Yugoslavia, Poland and Hungary. What is required is agreement within the framework of mostly new institutions, in order to implement the necessary reforms as democratically as possible. The government facing further economic and social destabilisation, and political anarchy, may prove strong even without such agreement, but its strength will not stem from popular support. Much as such developments would be undesirable, one cannot exclude this possibility. Thus, at the threshold of the nineties, the socialist countries /though not yet all of them/ came to face the problem of working out their own solutions with respect to the institutions of political democracy. There is no doubt these solutions will not be as uniform as they used to be, since each country will make its own contribution. What we are witnessing now, is a great historical experiment, which will yield a variety of solutions, though with the same principal objectives.

3. The Shortageflation Dilemma

The shortageflation syndrome is one of the major problems facing stabilisation policies in Poland and other socialist countries /Kołodko – McMahon 1987/. What I call shortageflation is a phenomenón unknown to the market economy, which is not merely a simple sum of price /open/ and repressed inflation, but a wholly new category. It is a very specific form of the coexistence of overall price growth and the accompanying redistribution of incomes and resources, with the permanent shortage of goods in the market.

The problem lies not only in the fact that prices soar while shortages persist and in the resulting choice between the scale of these two interconnected phenomena, but also in the fact that prices keep on rising while shortages grow ever more acute. In a way this is similar to stagflation, known to the market economy, where rising inflation is accompanied by rising unemployment. In the case of shortageflation the rates of price /open/ and of repressed inflation are rising, the latter being reflected in increasingly massive shortages. This phenomenon is to be observed in all socialist economies undergoing reforms in the second half of the eighties, but Poland's case is again the most spectacular /Kołodko 1988 a/.

The rate of price inflation showed a systematic decline between 1982 and 1985, falling from about 105% to about 15%. Then, it started rising again, and not only from year to year but, starting with the second quarter of 1988, from month to month. This was a predictable effect of the so--called "price and income operation" of February 1988. It was demonstrated once again, that instead of stabilising effects promised by the economic policy, it actually led to a further destabilisation. Thus, as price growth became faster, currency obviously also depreciated at a higher pace. This is illustrated in Fig. 1. What is striking, is the symmetry between the curbing of inflation in the years 1982-85 and its take-off in the years 1986-1989.

A 100 zlotys of the year 1980, which marked the beginning of the social and economic crisis, is now worth a little over 5 zlotys /Fig. 2/. In other words, taking the 1980 price level as 100 and predicting 1989 inflation to reach 110%, we end up with a 20-fold increase in the level of prices /Fig. 3/ and a corresponding decline in the purchasing power of the Polish zloty.

This purchasing power is actually even lower, since given the conditions of the economy of shortage, it must be measured not only with the amount of goods and services which can be bought for a nominal unit of currency, but also by the real chances to realize effective demand. And these chances are strongly limited due to parallel repressed inflation. Moreover, rising inflation in the eighties was accompanied by ever more acute shortages. There are no precise indices to measure repressed inflation, to match those used for price inflation, though there is already quite

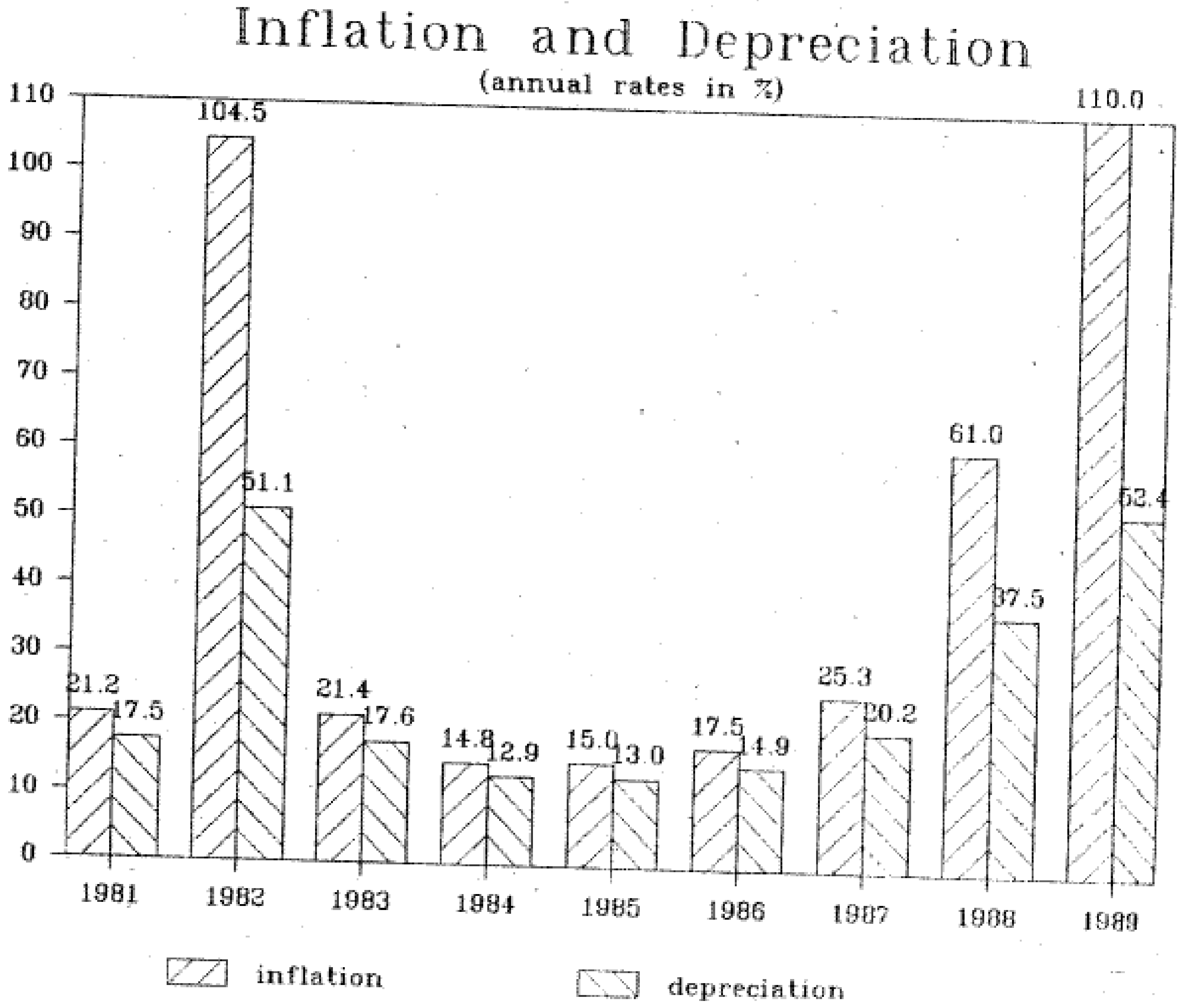
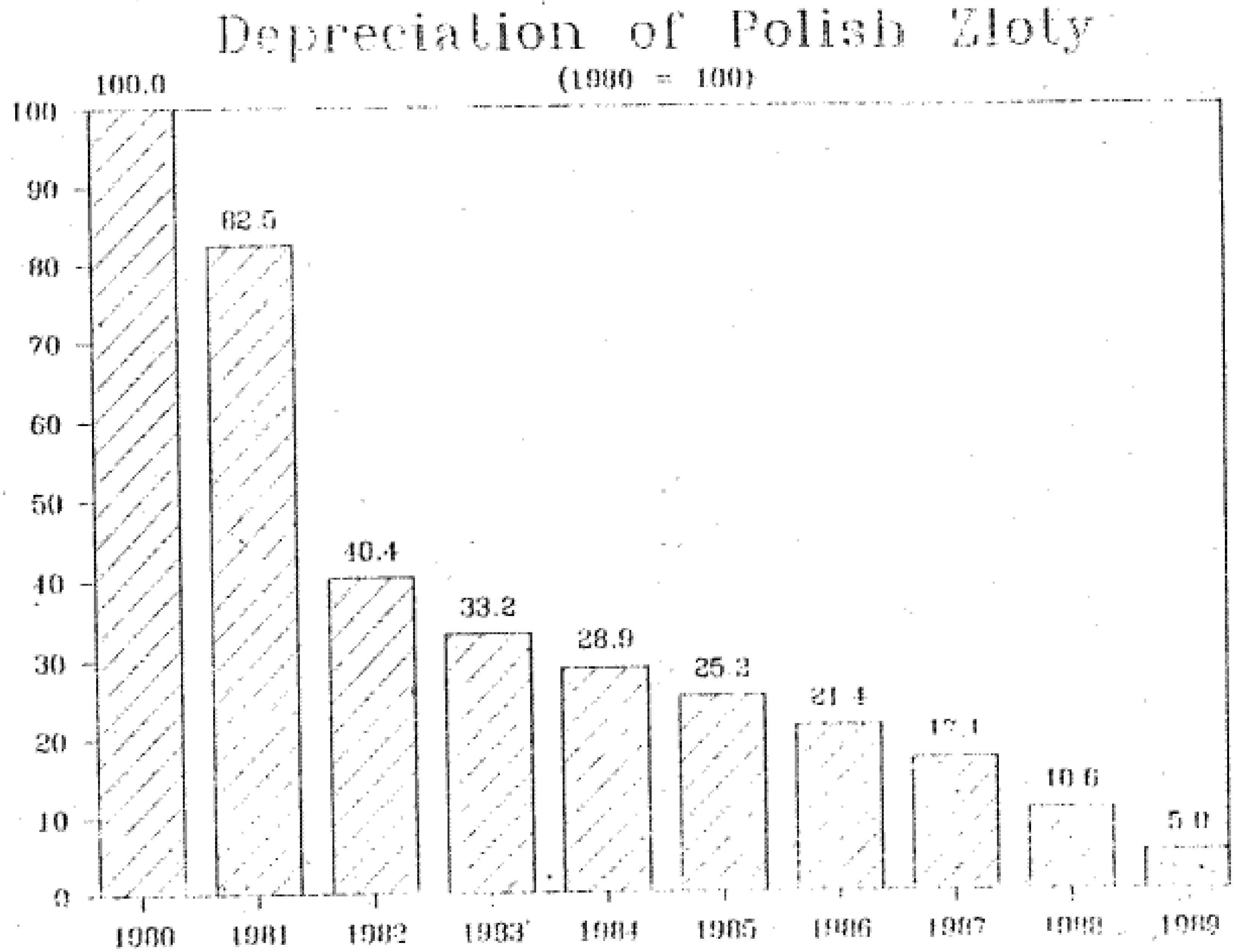
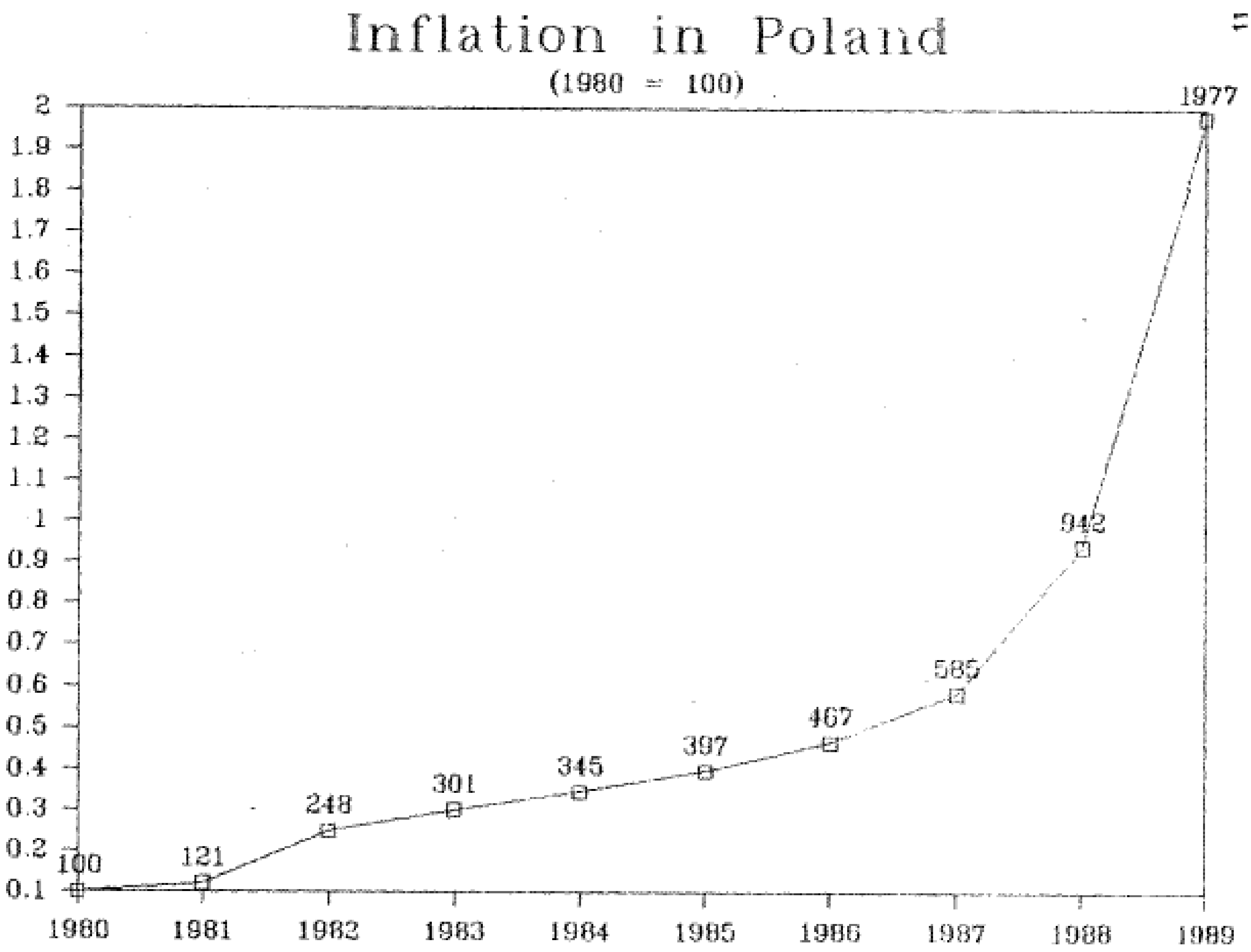

Inflation and Depreciation
(annual rates in %)
110
100
90
80
70
60
50
40
30
20
10
0
104.5
51.1
21.2
17.5
21.4
17.6
14.8
12.9
15.0
13.0
17.5
14.9
25.3
20.2
61.0
37.5
110.0
52.4
1981
1982
1983
1984
1985
1986
1987
1988
1989
inflation
depreciation

Figure 1

Figure 2


Depreciation of Polish Zloty
(1980 = 100)
100
90
80
70
60
50
40
30
20
10
0
100.0
82.5
40.4
33.2
28.9
25.2
21.4
10.6
5.0
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989



Inflation in Poland
(1980 = 100)
(Thousands)
2
1.9
1.8
1.7
1.6
1.5
1.4
1.3
1.2
1.1
1
0.9
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
100
121
248
301
345
397
467
585
942
1977
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989

Figure 3

an extensive literature devoted to this problem /Nuti 1986; Kołodko 1987; Miliuk 1989/. All available estimates show that shortages became even more serious in that period. Among other things, it was reflected in the increased volume of the inflationary overhang, in shop stocks falling to levels which no longer guaranteed a continuity of sales, the ever expanding scope of the second economy and the "dolarization" of the economy, etc. /Raport 1989/.

Rising price inflation, paralleled by increasingly serious shortages testifies to the inefficiency of short-term stabilisation of measures and longer-term measures of adjustment to the changing conditions macroeconomic reproduction. This appraisal holds for all three spheres: systemic reform, realignment of economic policy and structural transformations. This observation also leads to a certain conclusion. That the only variants of stabilisation policy which can be recognised as politically viable are those which ensure a parallel lowering of both open and repressed inflation /Kołodko 1989 a/. Neither the assumptions, nor the implementation of the "price and income operation" of 1988 met these criteria. What is worse, currently enforced measures do not fulfil them either, as they actually lead to a further rise in price inflation.

4. Financial Policy vs. Stabilisation Measures

A systemic market reform would considerably enhance the role of financial policy. But already here, we should observe, that its instruments frequently have a limited impact or even - that they are grotesque in comparison with their equivalents in advanced market economies. This can be said for example of the attempts to set up a capital market in a situation of massive shortages /Czekaj 1989/. The inefficiency of many of the instruments of financial policy is also partly attributable to the fact, that the national economy is now a hybrid: no longer centrally planned /actually, no longer planned at all/ but hardly a market economy, as yet. This is why the impact of such instruments as prices, taxes, exchange rates or the interest rate is limited or distorted. Companies are nearly immune to the influence of some of these instruments or their use leads companies to adjust in quite different ways than in advanced market economies.

These statements are hardly meant to imply that we should not have an ever broader recourse to the instruments of active financial policy, but on the contrary. However, we should be fully aware of the shortcomings of some of the instruments of this policy while balancing and stabilising the economy /Nuti 1988b/.

If we reject command-type, administrative methods of stabilisation policy and go on with marketizing the economy and monetizing economic relations, major changes will be required also in the national financial policy /Nuti 1988a/. Foremost amongst these changes should be shifting the emphasis from fiscal to monetary policies. This implies the enhancement of the role of the interest rate as an instrument designed to shape demand for money and regulate its flow to the economy. On the other hand, the regulation of financial flows with the use of fiscal policy instruments must be limited. Eventually, there would have to be less redistribution through the state budget, as this is what these postulates really come down to. State subsidies for unprofitable producers and company taxation must be cut. Thus, the argument about excessive fiscalism or excessive subsidies cannot be substantiated. What is justifiable is the conjunction of these two points of view, as the problem lies in too much redistribution through the state budget. One must add here, that limiting redistribution through the state budget will result in more redistribution through the market. Having said that, we must stress that the more balanced the economy becomes the less problems concerning redistribution we shall have.

In the light of this just postulate calling for the shifting of emphasis towards monetary policy, it is worthwhile to devote some attention to the issue of the so-called "real" interest rate. It is usually understood as an interest rate higher than the current inflation rate. This is not entirely accurate, because what it really means is a positive /in real and not nominal terms/ rate, while a real interest rate actually means a rate which balances money demand and supply. Just as a real price is an equilibrium price /and not simply an unsubsidized one, though this approach seems to dominate in all discussions on the stabilising functions of pricing policies/, a real interest rate is not one which is simply higher than the overall inflation rate, but an equilibrium rate which balances the demand for money from all economic sectors with its supply for the whole economy. In our further deliberations however, we shall adopt the more widespread interpretation, of an interest rate higher than the inflation rate.

There is a common and sound postulate to reach a positive /in real terms/ interest rate. The problem is that t h e r e i s n o w a y t o e s t a b l i s h w h a t t h i s r a t e s h o u l d b e. The market would take care of that in an advanced market economy, but cannot do it in a destabilised, "post-planned" socialist economy. The monetary autohorities cannot to it either, b e c a u s e i t i s a n i m p o s s i b l e t a s k u n d e r e v e r h i g h e r i n f l a t i o n a n d p e r s i s t e n t s h o r t a g e s. Given these circumstances, after a short period for adjustment, inflation would again rise above the interest rate. This is connected to what might be called a specific balance of the anti-inflationary and inflationary effects of interest rate increases.

The anti-inflationary effects are connected with two processes. First, there is the decline /though, what must be emphasized, only temporary/ in the demand for money from various sectors, especially from the companies. Companies opt for less liquidity, use more of their own funds as working capital and channel a higher proportion of their own funds into investment. Demand growth on the macroeconomic scale is lower, especially for capital goods, but consumer demand also falls, due to the indirect effects on the wages.

Second, there is the increase, though also only temporary, in the propensity to save. This effect concerns mostly the households. This adjustment process results again in a slower growth of demand, which has an anti-inflationary impact.

Both these processes were to be observed on a certain scale in Poland in 1988, when the maximum interest rate was set at 30%. It was meant to be the so-called "real" interest rate, since it was three points higher than the inflation rate assumed in the Central Annual Plan /after the elimination of the lag effects from the previous year/. The so-called "new" price growth was not to exceed 27%. Such calculations are obviously incorrect and are more of a manipulation designed to produce short-term political effects. In reality, inflation rate was planned to be 45%. Eventually, it exceeded 61%, meaning that it was more than twice as high as the maximum interest rate, as the average interest rate on the deposits of the non-socialized sector was 22,5%, which resulted from the structure of the deposits of this sector of the national economy in the banking system.

These processes were even more apparent in 1989. There, attempts were made to correlate the interest rate directly with the inflation rate, setting the former as a ratio to the overall inflation rate assumed in the plan. The problem however was that, as was stressed before, that this is not a planned economy any longer. Projections set inflation at 55% /even in documents adopted by the Parliament as late as mid-February /. Actually, inflation in the first half of 1989 exceeds 75% in comparison with the corresponding period of the previous year and continues its rise. The monthly price growth is equal to about 8%, which gives an annual inflation rate in excess of 160%.

Hence, the gap between the inflation and the interest rates kept on widening, instead of being nearly closed, which had been announced /with the usual fanfare/ in statements on economic policy. Why was it so?

There is no doubt that rising inflation in Poland, and in other socialist economies, is affected by a whole set of relatively well-known and described causes /Adirim 1983, Nuti 1986, Winiecki 1986, Kołodko 1987/. There is no need for their broader presentation here. What must be stressed however, are the inflationary effects of the attempts to achieve a "real" interest rate. They are twofold.

First, given the important /more than twofold, as the maximum rate had been set at 65% for 1989 and it will no doubt be revised upwards/ increase in the interest rate paid on savings deposits, there will be an important growth in the incomes, especially of the households. This important source of additional demand, created solely by higher interest, will no doubt absorb a large proportion of the additional supply predicted for this year.

Second, bank credit is becoming increasingly expensive which, given the automatic inclusion of its cost in production costs and into prices, will send the overall price level still higher. After a slight drop in the demand for credits in early 1989, the inflationary character of adjustment processes led to recovery to at least the previous level. In other words, the publicly declared anti-inflationary effects of the attempts to achieve a "real" interest rate, actually fuelled inflation. Inflation still has the upper hand. Inflation and interest rate patterns are illustrated in Fig. 4.

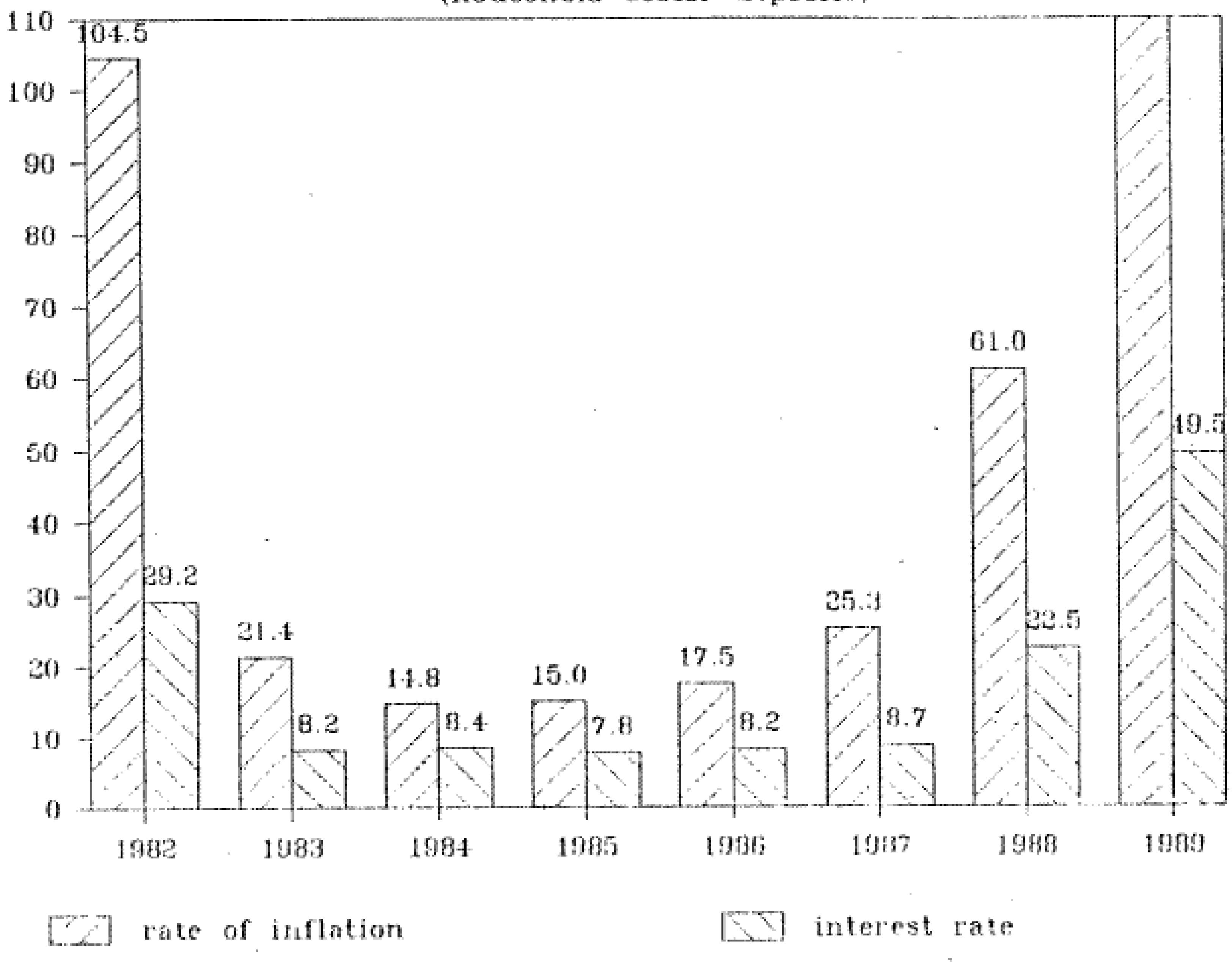
Does that mean that raising the interest rate makes no sense? Of course not, since the smaller the gap between the inflation rate and the interest rate, the lower the losses of the depositors, the less redistribution via the banking system, shifting resources and incomes from those who save, to those who borrow. All I am trying to prove here, is only that such a policy will not ensure a lasting, long-term, positive /in real terms/ interest rate and not even in the medium-term.

Attempts to achieve a positive /in real terms/ interest rate can succeed only when inflation is falling. That was the case in Poland in the years 1982--85 /see Fig. 1/ and that was the time to take steps to set the interest rate on deposits and credits above the falling inflation rate. At that time however, this postulate did not find the necessary support, was not espoused by the economic policy which, it might be believed, underlaid the inflationary take--off in the subsequent years.

Figure 4

Interest Rate and Inflation Rate

(household sector deposits)



It is in this light that we must formulate an economic principle which should be observed in the implementation of stabilisation policies. Namely, that in an economy of shortage, attempts to achieve a "real" interest rate, by setting it higher than the inflation rate, will strengthen the current trend with regard to inflation. If, at a given time, the inflation rate is falling, then such adjustment of the interest rate will further curb inflation. And conversely, when such attempts are made while inflation is on the rise, a higher interest rate will send the overall price level still higher. Thus, an efficient stabilisation policy must first lower the pace of price growth and only then can it set the interest rate above the rate of price growth. It is therefore clear that the prime task of the stabilisation policy must consist in reversing the coexistent trends of the accelerated price growth and of the ever more serious market disequilibrium.

Some of the postulates put forward in the "Position on Social and Economic Policy and on Systemic Reforms" worked out at the "Round Table" talks /Stanowisko 1989/ seem to meet these requirements. While the whole set of measures proposed there seems to have an inflationary character, it does include a number of sound postulates concerning specific issues, especially those calling for the balancing of the demand and supply of capital goods, of the state budget and the adjustment of the overall company and household demand to the supply capacities of the economy. It is worthwhile to stress, in the light of earlier comments with this regard, that it is assumed that the automatic crediting of state budget deficits by the central bank will be abandoned. These deficits are to be financed by non-inflationary methods, among other ways, through the sale of some elements of state property and through the emission of securities, purchased by the companies and households.

The problem however is that unless more progress is achieved in curbing inflation, there will be little interest in purchasing such securities or in the development of the capital market, failing which one can hardly expect to balance supply and demand in the national economy. Hence, what we are facing here is a system of negative feedbacks, where once again, inflation is the key factor. No major advances in stabilisation can be expected unless there is some major breakthrough with respect to inflation.

5. Stabilisation Measures versus Consumption and Wages

The need to lower the living standards of certain social groups may be one of the very unpopular elements of stabilisation policies, especially in the short run. This issue merits more attention, as it often leads to various misunderstandings. We often hear the postulate - also advanced by Polish economists /Kleer 1989/ - that the crisis cannot be overcome without a further fall in the population's living standards. Here we shall treat this living standard at par with consumption from the national income, although this is methodologically incorrect, as the category of real consumption would be more appropriate. Real consumption covers more than consumption from current national distributed income /including foreign transfers/, including also the value of consumption resources amassed in the past and the value of households' own production and services. It can happen in a crisis /understood as economic recession/ that consumption in terms of the distributed national income may fall, while real consumption will still rise, or at least fall at a lower pace. M. Pohorille called this phenomenon the "lag principle" /M.Pohorille 1982/. It no doubt occurred in Poland in the early eighties. However, we shall concern ourselves with another problem here. Namely: whether or not the implementation of proposed stabilisation and adjustment measures really necessitates lowered consumption /ex national income/.

I feel there is no such necessity, though there is a need to lower real personal incomes /including wages/. These two statements are not as contradictory as they may appear, if the analysis is confined to the macroeconomic scale and/or considered in terms of averages. This ostensible paradox of a decline in real wages accompanied by rising consumption is possible only under the conditions of an economy of shortage, i.e. under inflationary disequilibrium. As it is known, the latter is the only type of disequilibrium known to the socialist economy. Let us focus on this issue and try to explain it drawing on recent Polish experiences.

In an economy which is experiencing strong, though partly repressed inflationary pressure, demand permanently exceeds the supply. In the long run, this leads to the creation of the so-called inflationary overhang /Herer-

Sadowski 1981, Kołodko 1986, Nuti 1986/. Under such conditions, even when the overall pace of price growth /inflation rate/ is higher than the growth rate of nominal personal incomes /wages/, household consumption can still grow. After all, consumption is a function of production and of the supply of consumer goods or, even more precisely - of their real sales - and not of the overall level of real incomes. Let us consider this on an example.

In year t_0 nominal household incomes were 100 units, whereof 95% was earmarked for consumer expenditure, while 5% for the increase in voluntary savings. The supply of goods /actually sold/ however, was only 90 units, thus compulsory savings /i.e. imposed on the households by the shortage of goods/ were also 5 units. In year t_1 nominal wages grew by 10%, achieving the nominal level of 110 units. Inflation rate at the same time was 14%, thus the price index was 114. This means that real wages fell by 3,5% i.e. to 96,5%. The supply of goods to the market - which is a function of other variables - increased over this period by 2% /e.g. thanks to increased productivity/,which means that supplies to the market were equal to 91,8% of the preceding year's level /in terms of volume/ and to 104,6% in nominal terms. The propensity for voluntary savings remaining at 5%, the households would have saved 5,5 units from their incomes /which for our purposes we assume to be equal to wages/. Effective demand was therefore 104,5 units /current nominal incomes less increase in money balance due to voluntary savings/. This demand was met by a supply increased by 2% in real terms, in comparison with the preceding year, or 104,6% in nominal terms. The entire supply was sold and - assuming that households did not stockpile - consumed. Thus, consumption grew by 2%, for that was the growth in production /and also in supply, spending and lastly - consumption/, even though real incomes had fallen by 3,5%. These figures more or less reflect the situation in Poland in 1987, when real wages fell by 3,5% on the average, while household consumption grew by about 3% and about 2,4% per capita.

Let us observe on the macroeconomic scale, the "cost" of this trend was the elimination of compulsory savings, which fell from 5% in year t_0 to zero procent in year t_1. To make the picture complete, we must add that the stocks of goods grew by 0,1% in year t_1 in current prices, which is due to a slight excess of supply /104,6%/ over demand /104,5%/ created by current incomes. This is precisely the desired stabilisation effect which is to be sought in the lowering the level of real incomes in an economy of shortage. Thus, this effect can be achieved without lowering the average consumption level, as long as it is possible to maintain an economic growth structure capable of keeping consumption on the rise.

Naturally, the inverse may also be true. It is possible to have an increase in real wages /in the statistical approach/ accompanied by declining consumption, or even a disproportionately high increase of wages comparing to the actual growth of production and consumption. This was the case in Poland in 1988, when a 3,1% increase in consumption was accompanied by a nearly 14% rise in real wages! Recent patterns with this regard are illustrated in Fig. 5.

The core of the problem lies in the fact that the relationships discussed here apply to the macroeconomic scale and to averages. In the real-life social and economic mechanism, a 3,5% decline in real wages accompanied by a 2,4% rise in consumption, means only that it was how things were on the average. The higher the inflation rate, the more important are the deviations from this averaged picture. This is why stabilisation policies calling for the lowering of real wages /without a decline in the average - and let's stress the word "average" - consumption level of the households/ are all the more difficult to implement, insofar as social acceptance is concerned, the higher the inflation rate. And yet, it is then that this acceptance is needed most badly.

The situation in Poland is rendered still more complex by at least two factors. First, comes the widespread attitude, that no decline whatsoever in real wages is acceptable, that the Polish society had already paid dearly and enough for the crisis. This hinders constructive discussion, which among other things, should clearly point to the difference between real wages /in formal and statistical terms/ and consumption. Let us make it clear however, that that is not the only point here. We must remember that in our theoretical example, the households were left with nominal savings of 10 units in year t_o, but half of that were compulsory savings induced by shortages. In year t_1, they ended up with savings of 5.5 units, pointing to the stabilisation in the real level of savings and there were no compulsory savings on the macroeconomic scale. I believe that this beneficial stabilising effect is unwelcome from the microeconomic point of view of the households, due to the impression that they are losing money.

The second factor which complicated the situation with this respect, was the discontinuous nature of real income and wage growth in 1988. It has to be negatively offset in the subsequent periods, unless some other outlet, like e.g. voluntary investment, is provided. It appears possible in view of

Consumption and Real Wages

(annual rate of growth in %)

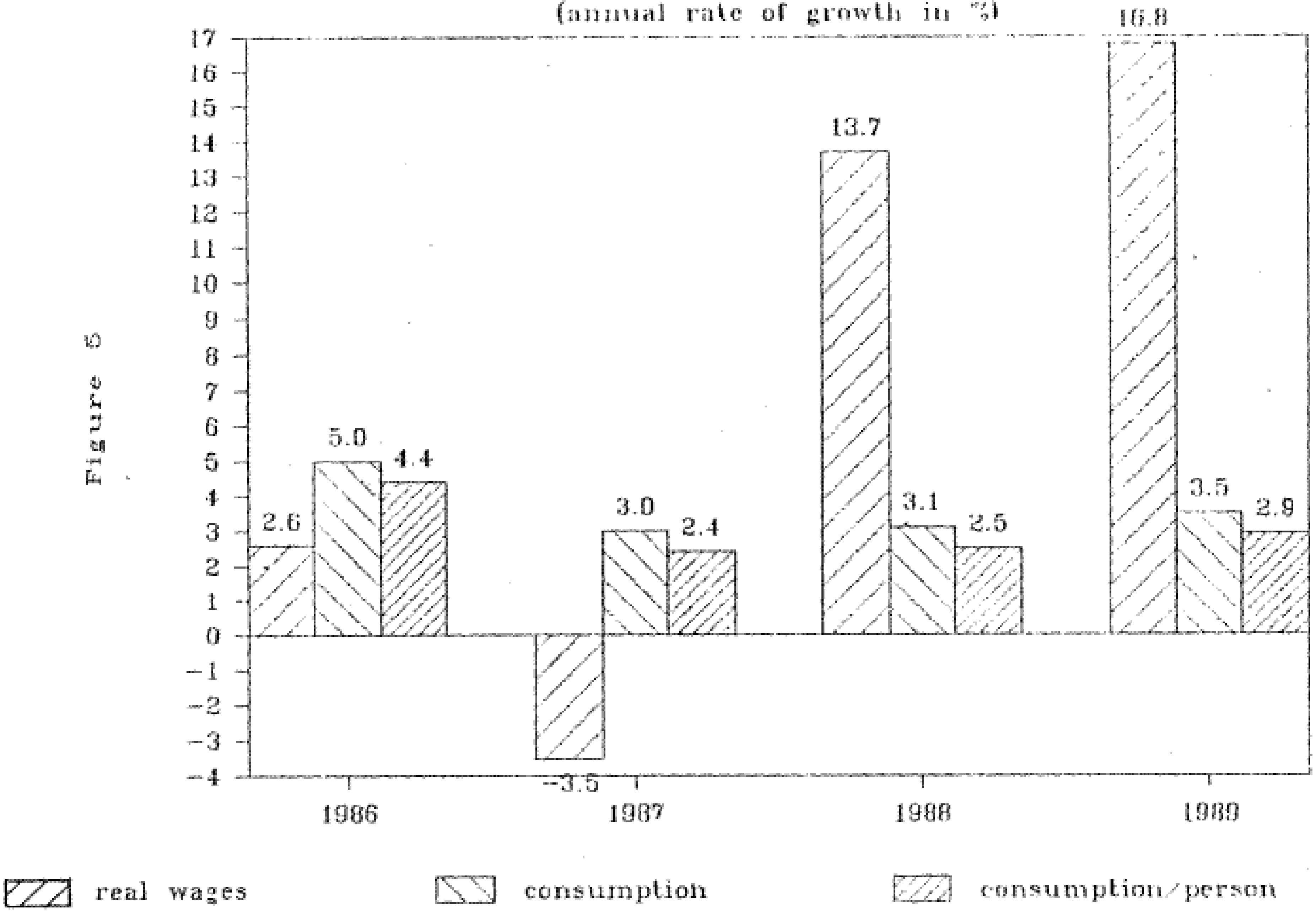


Figure 5

the newly created opportunities for private enterprise and for private investment in productive activities. What is most important however, is to no longer drain excessive financial r e s o u r c e s from the households but to match supply to c u r r e n t personal incomes.

Keeping in mind economic, social and political constraints, it would appear that as far as the real growth of personal incomes /especially wages/ and consumption are concerned, socialist countries suffering from high inflation should follow stabilisation policies characterised by certain definite features. First, they should stabilise real wages for at least several years or even - in extreme cases /Poland being one/ - lower somewhat their average level. Second, there should be a moderate growth in consumption, in line with the growth of the distributed national income, that is after the necessary deductions for the service of a part of the foreign debt. Third, stabilisation should gradually rein in price inflation /insofar as practicable at a given stage of the adjustment process/, to minimize wealth and income redistribution, i.e. to minimize deviations from the standard situation for all households. Fourth and last, necessary protection ought to be given to the economically weakest groups, to avert an excessive lowering of living standards among these social strata. There is no doubt, that such lowering of living standards will be inevitable with regard to quite numerous groups of the population. That is the price of stabilisation measures or rather the cost to be borne to overcome economic crisis.

6. Attempts at Stabilisation - Economics and Politics

Each country has its specific features. Apart from the generalities, even crisis, adjustment and growth have a number of specific traits. They sometimes decide on the rarity, or even exclusivity of some phenomena and processes, in other cases they only determine the specific forms in which certain general trends and patterns are manifested. It is the latter that we are most interested in. It is also in this context that one should view the successive attempts to bring the crisis of the Polish economy in the final years of this decade under control and to overcome what I call the general crisis in the socialist economy in the final years of this decade. I specifically refer here to the "Plan for the Consolidation of the National Economy" /Plan 1989/ and the deliberations and results of the "Round Table" /Porozumienia 1989/.

The "Plan for the Consolidation of the National Economy" came into being as yet another initiative aimed at stabilising the national economy after several successive failed attempts /or failures to even try - as was the case of the "Program for the Strengthening of the Currency"/. Specifically, it was a reaction - and a very prompt one at that - to the catastrophic outcome of the price and income operation /sometimes referred to as "price-list and compensation" operation/ of February 1988. As stressed before, the situation escaped control and rising open price inflation, which exceeded the planned 45% to reach 61%, was accompanied by a visibly stronger supply inflation. Already massive shortages became even more dramatic. This was followed by stronger social discontent, leading to the staging of various protests and strikes. The beginning of the implementation of the so-called "2nd stage of economic reform", designed to bring economic, social and political stabilisation, produced quite the opposite effects. These developments led to the demise of the government - first time ever in the history of the socialist countries. It is worth stressing, that the motion calling for the resignation of the cabinet was put forward - publicly at least - by the so-called "official trade unions".

The government resigned but the system remained. Problems waiting to be solved, more complex than ever, remained too. Rising inflation, ever stronger economic disequilibrium and growing foreign debt are the foremost. Wage disparities are also increasing, entailing all the obvious social and political consequences, while the definitely undesirable structure of prices is setting in. One may say that the situation in 1989 is much more difficult than in the beginning of the decade, despite many attempts at its improvement made in the meantime.

The "Plan for the Consolidation of the National Economy" put forward in August 1988 at the 7th Plenum of the Central Committee of the PUWP, which the Parliament adopted after much discussion and controversy in February 1989, was designed to change this state of things and of the negative trends it produced. Unfortunately, it proved to be yet another plan of wishful thinking. It concetrated on inflationary goals derived from social motivations, rather than on strict, stabilising measures. High priority was given to the food industry, housing and environmental protection. Attempts to found the "Plan for the Consolidation... " on the otherwise sound assumptions of the "Program for the Strengthening of the Currency" /Program 1987/, which assumed a subordination of state economic policies to the challenges posed by the need to contain economic disequilibrium and inflation failed, because the mechanisms of negotiation and consultation - so desirable in principle, when our economic and political life is undergoing democratization, but which are not a substitute for democratization - often lead astray to rotten compromises. Instead of radical, consistent and - above all - comprehensive measures, it all came down again to attempts to conciliate incompatible postulates of economic policy.

It must be emphasized that the "Program for the Consolidation of the National Economy" should have been correlated to the corresponding adjustment program negotiated with the International Monetary Fund. In a certain sense, it was to be its internal, domestic version. This however was not the case. Eventually, it came out that it was impossible to elaborate a single plan of stabilisation measures, which would meet both the main criteria put forward by the international financial community and those of the population. A stabilisation plan for Poland, and actually for many other countries, including Yugoslavia and Hungary, would have to reflect a certain compromise between these two contradictory positions. I believe however, that the only measures which offer some chance of success are those which will be aimed at the gradual overcoming of the shortageflation syndrome.

The consolidation plan does not offer such opportunities, because it is not really aimed at curbing inflation. Actually, this should not be a source of concern, since under the present systemic and political circumstances, such a plan cannot be viewed as a real instrument of macroeconomic policy. I fully support my earlier statement, that this is no longer a centrally planned, but not yet a market economy. Moreover, the life expectancy of the consolidation plan has been clearly shortened and its importance changed, following the results of the "Round Table" and the consequences that its settlements may have for the stabilisation of the national economy and for its growth.

The idea of the "Round Table" came into being more or less simultaneously with that of the consolidation plan. Its sense consisted mostly in the political aspects, which cannot be underestimated. The very fact that people representing different ideologies and political convictions met and negotiated, merits praise and testifies to progress in democratization.

Some elements of the settlements achieved at the "Round Table" will no doubt have a positive impact on the systemic sphere. Settlements concerning the so-called "new economic order", which further develops the correct assumptions on the marketization of the economy, are amongst the foremost. Despite differing rhetorics, the elements of new economic order are essentially a continuation - despite a somewhat different distribution of emphasis, an intensification of certain steps and a radicalization of certain solutions - of the guidelines adopted in the program for the implementation of the 2nd stage of economic reform and in the consolidation plan. It is no doubt an important step forward in the process of systemic transformations, which I called the "triple D" /as an analogy to the already traditional "triple S"/, referring to deregulation, demonopolization and democratization /Kołodko 1989b/.

While settlements concerning the area of systemic adjustment raise rather less objections and doubts, the postulates concerning economic policy must lead to objections. Here again, politics dominated over economic rationality, with the sole difference that this time the opposition is to blame, rather than the government. The opposition was also guided by its short-term political interests, connected with its legalized renaissance in the enterprises. The suspension of strikes resulted in the forced settlement on a general system of wage indexation, which - facing inflation in the region of the psychological three-digit level and massive shortages - added another factor to the already very strong mechanism of the inflationary spiral. This reflects passive subordination to inflationary processes, resulting from the inability to stand up to it.

General and automatic indexation will further fuel inflationary processes, checking at the same time the opportunities to introduce necessary changes in the structure of prices and incomes. This will prevent any efficient operation on the part of mechanisms designed to provide incentives for better work.

While attenuating - and only temporarily - the wage demands of some social and professional groups, the system of general indexation will only boost demands put forward by other groups and also - further weaken the impact of the new financial and economic mechanisms, which are so difficult to set in motion under the conditions of rampant shortageflation. Widespread and automatic indexation of wages and other incomes is justified only with regard to the sphere of non-productive services and some social benefits, especially disability and old-age pensions and scholarships. With regard to the productive sphere, it would put in question the whole set of stabilisation measures, including those proposed in the "Round Table" settlements.

The idea which professedly underlies the postulate of generalized indexation is connected to naive faith in the appeasement of social attitudes. Actually, that is quite impossible, due, among other things, to the strength of social demands, the time lag between the adjustment of wages to rising living costs or - more precisely - to the important and hardly controllable differences in this time lag. Indexation in an economy of shortage can be hardly compared to that in market economies. In the first case, the households form their expectations with respect to inflation and their demands basing on their subjective appraisal of price movements in the free markets /alternative, black, etc./, where these movements are much stronger, rather than on the average increases in the cost of living.

The adoption of automatic indexation, at the threshold of three-digit inflation and with major shortages, would be tantamount to a quantum leap into rampant inflation. I understand this phenomenon as a scale of inflationary processes where wage movements are no longer connected or related in any way whatsoever with changes in the effectiveness of production or labour productivity, where savings lose their sense, while inflation turns against economic growth. Eventually, such developments must end in a monetary reform. The implementation of such reform however, may prove incompatible with the further democratization of political life.

Given the existing set of circumstances, such an ill-considered decision on introducing generalized indexation, will produce a situation where monetary reform will be only a matter of time. It is likely that in the meantime, we may have yet another unsuccessful stabilising operation, that is a freeze on wages and prices. Obviously, such a freeze will not cure the causes, nor the far-reaching consequences of inflationary processes, but will at least cut down the population's expectations of inflation and allow some time required to prepare further action. Actually, a freeze on wages and prices would have more sense under the present circumstances, much more than generalized indexation, which offers no positive solution to the situation. It seems however, that political considerations had once again outweighed economic reasons. Short-term political interest had once more triumphed over long-term economic interests. This time however, the responsibility for this ill-considered economic policy is not only the government's, as before, but also of the opposition, though there is no doubt that the authorities will get all the blame. That is the cost to be paid for this late birth of democratic institutions in Poland.

7. External Aspects

While discussing economic stabilisation and its long-term adjustment to growth challenges, one cannot forget the external determinants of these processes. One the one hand, these are the efforts made by some socialist countries to achieve more openness to the external world and, on the other - developments which follow their course in the surrounding world independently of what is going on in the socialist economies; even if there is a lot going on, like the end of an era, which is symbolized in Soviet perestroika /Desai 1989/, which has its positive implications for reforms in other socialist countries, including Poland.

The opening up of socialist economies to the external world /Bożyk 1989/ is reflected, among other things, in attempts to set up joint ventures and it must be said, that notable progress with this respect has been achieved, among others, in Polish legislation on joint ventures, enacted in 1989. There are also political reasons which lead to a greater inflow of foreign capital also to other countries, especially China and Hungary and, lately, to the USSR. It is, however, the internal social and political stabilisation in these countries, as well as the methods and time required to achieve currency convertibility, that are decisive for a more significant inflow of foreign capital, joint ventures, direct foreign investment and suchlike. Some progress can be also observed with this respect - so far only with respect to limited internal convertibility - especially in Poland.

The second aspect of the external implications of adjustment processes in the socialist economy concerns some global and regional processes, which no doubt bear on what happens in these countries and particularly on their growth prospects. I specifically refer here to the worldwide debt crisis, which also affects some socialist states /mostly Poland, Yugoslavia and Hungary/ and the progress of integration in Western Europe, about to culminate in a single market uniting 12 West European states of the EEC after 1992.

The current situation with regard to worldwide debt cannot last. The existing debts simply cannot be paid back, even if we consider the so-called "unconventional" methods of debt service and repayment, in the form of a secondary debt market, swaps or transactions involving the writing off of a part of the debts for environmental protection. Major changes can be expected as goes for the approach of creditors towards their debtors. Such changes are already taking place with regard to some developing countries. This is not only humanitarian concern. It is also common sense, since it is obvious that these debts cannot be repaid anyway. The debts of some of the poorest African states are being written off, while the proposals of the new American administration, presented by Nicolas Brady, the Secretary of Treasury, actually imply the relinquishment of the major part of Latin American debt to American commercial banks.

Comes the question about the realtionship can this have to the indebtedness of the socialist countries, already in excess of 120 billion dollars. It would appear that such a relationship can be noticed in the case of Yugoslavia, Hungary and Poland. Their foreign debt amounts to 22 plus, 18 and 39 billion US dollars, respectively. Given their structurally limited export capacities and internal problems, none is able to assure full debt service, which is why their debts are piling up. Yugoslavia and Poland had repaid over the last two decades more or less the same amounts that they still owe to the richest countries. Moreover, as I had stressed before, there is no solution which would simultaneously solve the problems of internal and external equilibrium. Such a situation cannot last. Thus, major changes with this regard can be expected and they are likely to be connected with political changes which these countries have initiated and which are already in progress.

Thus, potential changes in the external determinants of economic growth, resulting from a new approach of the creditors, can facilitate and help in accelerating stabilising and adjustment processes. There are obvious feedbacks between the foreign debt burden and the capacity of the economy to finance the necessary structural transformations, failing which even farthest-reaching changes and a realignment of economic policies, and of policy in general, cannot produce the desired effects nor create the premises for long-term social and economic development.

Accelerated West European integration, leading to the formation of a single market after 1992, is another important factor bearing on the external determinants of economic growth in the socialist countries, especially in the small and medium East European states. This market will be second only to North America, and not only for goods, but also for services, capital and labour. Leaving aside a number of issues which West European countries must still solve on their way to integration, one must remember that this is a major challenge for other states and it is factor to be reckoned with in the elaboration of their growth strategies.

Theoretically speaking, there are four possible scenarios for the development of the mutual relations of the European socialist countries with integrated Western Europe. The first is a scenario of continuity, consisting in the persistence of the present trends, with only minor changes. This would be reflected in efforts aimed at "the further strengthening and streamlining of socialist integration" in the framework of the Council of Mutual Economic Assistance, embracing also the Soviet Union and three non-European member states: Cuba /Roca 1989/, Mongolia and Vietnam /Goodman 1989/. This scenario would mean that East and West European countries would grow increasingly different and any chances for a some major future rapprochement would be eliminated.

The second scenario could consist in the strengthening of the real integration processes within the Comecon, especially amongst its European nembers, founded on reformed, market economies and a common, convertible currency. Such a community as a whole, would grow closer to West European economies through dynamically expanding commercial and financial contacts, as well as the transfer of people, capital and information. This scenario seems to be advocated by the bureaucrats connected with the existing patterns of bilateral trade which, under the cover of the CMEA, had actually dominated over multilateral contacts.

The third scenario could be the dissolution of the CMEA in its form known thus far and the members would look for their own solutions in the new situation. This scenario is as unlikely as the second.

Lastly, the fourth is a scenario of diversification. Some economies will evolve more rapidly towards economic integration with Western Europe, while other will remain in the framework of their present economic relations. An increasing economic rapprochement to integrated Western Europe does not imply the severance of ties with other socialist states. These contacts are often beneficial and appear rather durable, though the dominance of competitive economic structures over complementary structures, reflected in the likeness of these countries' economic structures is a barrier to more modern and advanced forms of economic cooperation.

The fourth scenario is also the most likely. Actually, its implementation is to some extent already under way. Some Comecon countries have already concluded agreements on collaboration with the EEC /Czechoslovakia, Hungary, Romania/, others - including Poland - are striving to intensify economic ties with the EEC. Y·goslavia - though not a member of the CMEA and not a member of the Warsaw pact, which has a special importance in this context - is in the most advantageous position with this respect and has the best chances to first become an associate member of the EEC. Hungary and Poland appear to have the chances to be second and third. There is no doubt that these contries are more European than e.g. Turkey. Here however, we come once again to the dominance of politics over economy, this time on the international scale.

The reply to the question about the pace at which the socialist economies will grow nearer the integrated Western Europe, while maintaining strong and parallel integration ties with other socialist states, will depend mostly on the success of their reformatory efforts. Success in the market realignment of their economies, monetization of economic relations and democratization of public life institutions may, though not necessarily, make this rapprochement nearer. On the other hand, given the overall nature and patterns of change in the contemporary socialist economies, a certain acceleration in the creation of more advantageous conditions of commercial, financial, technical and capital collaboration with West European countries should be a catalyst for adjustment processes in the socialist economy. However, as is the case of all catalysts, this factor will come into play only when the societies and authorities of the countries concerned will effectively implement the necessary changes. These changes will have to cover the set of the indispensable, radical and consistent measures with regard to the operation of the national economy /economic reform/, appropriate market structural transformations and a realignment of economic policy. Action along these lines will also call for further and substantial progress in the democratization of social and political life, while averting the risks of anarchization which unfortunately, cannot be excluded. And it is only the process of adjustment in the socialist economy, understood as explained above, that offers the chance to overcome its general crisis and the creation of premises for durable social and economic development in the future.

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