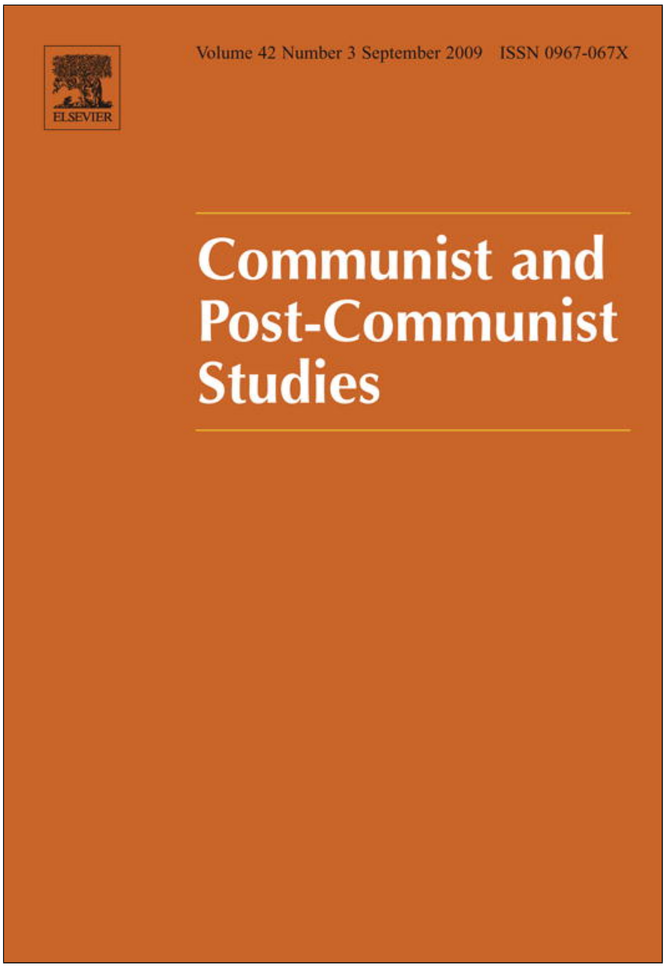
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A two-thirds of success. Poland's post-communist transformation 1989–2009

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Abstract

The progress toward institutional changes should be evaluated through the prism of their influence on a country's development abilities. In Poland, during the twenty years of comprehensive systemic shift, gross domestic product (GDP) has increased more than in any other post-communist country. While judging the transformation progress, not only the improvement of competitiveness and growth in terms of quantity must be taken into account, but also social and cultural aspects. There have been five distinct periods in Poland, from the viewpoint of economic growth. Had there been a better policy coordination of systemic change and socio-economic development, GDP over the periods considered could have increased by a half more. This opportunity has been missed due to the intermittent implementation of wrong economic policies based on wrong economic theories. Poland's transformation can be seen as a success, but only to the extent of two-thirds of its potential.

Keywords: Transformation; Economic growth; Development; Institutions; Economic policy; Post-communist; Poland

The ill-advised 'Washington Consensus'

The twenty-years period of time – since the Polish Round Table and the subsequent fall of the Berlin Wall – consists of distinct five periods. After the historic year 1989, which significantly changed the face of the world, and not only Poland and the

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region, there came the years of a 'shock therapy' or – as others prefer to call it more accurately – a shock without therapy. The economic policy in this first period, the years 1990–93, was generally based on the neoliberal doctrine, very often identified with the so-called Washington Consensus, whose usefulness for the complex work of post-socialist systemic transformation was limited. Similar tendency could be observed in some other, post-socialist countries. Some of them, Slovenia in particular, benefited much from resisting such influence.

John Williamson, the author of the term 'Washington Consensus', which has become a worldwide catchphrase, draws attention to its overzealous interpretation. Particularly, he distances himself from considering privatization as an overriding priority, as it happened mainly in the neophyte version of neo-liberalism. He claims that

> …privatization remains a desirable objective, but that more attention needs to be paid to the way in which it is achieved than has often been the case in the past. There needs to be more attention to ensuring that privatization is, and is seen to be, squeaky clean. If that restrains the pace at which it is carried out, so be it. The objective should not be "privatize as fast as you can" (as Kolodko (1998) once claimed the Washington Consensus demanded), but to privatize in a way that will increase efficiency without concentrating wealth. (Williamson, 2005, p. 10)

Unfortunately, there were political forces which, under the overwhelming influence of external advice, forced and imposed on the society a program of liberalization and stabilization that was not relevant to the Polish reality. It turned out that for political reasons it was very easy to gain social acceptance for the excesses of a shock without therapy. Nowadays, much is being written about the losers of transformation and Solidarity's defeat (Ost, 2006) because critical advice and many warnings at that time were disregarded. It must be, however, strongly emphasized that other programs were suggested (Laski, 1990; Nuti, 1990; Kolodko, 1989, 1990), despite the cacophony about the alleged absence of the so-called 'alternative'.

There were direct warnings that the application of the proposed – and unfortunately realized – package of liberalization and stabilization, known as the Sachs-Balcerowicz plan, would contribute to a drop of industrial production by 25 percent in the first year, followed by mass unemployment, which in no way would result in one percent of monthly inflation rate, as it was promised by the government and its finance minister. Such criticism was ridiculed by government advisors although – as it turned out quite soon – it was fully justified. The government assumed only one-year recession, a drop of GDP by 3.1 percent, unemployment of 400,000 people (which would signify a moderate unemployment rate below 2.5 percent), all immediately followed by a phase of economic growth (Program, 1989). Reality was dramatically worse.

At that period, particularly in 1990–91, the stabilization policy was definitely missed. It was too restrictive, mainly as regards its monetary and fiscal aspects. Interest rates were definitely too high and instead of being oriented toward the future and cool down the expectations, they were based on inflation rates of a preceding month, which actually constituted their extrapolation. What is worse, they also referred to old debt. Liberalization of foreign trade, from which the government partially withdrew already in 1991, went too far. The range of zloty devaluation was excessive and the period of its nominal freeze by means of inflexible peg to US dollar and not – which would be better – to the currencies basket that would reflect the structure of the balance of payment, was too long. For political reasons public and co-operative sectors were discriminated against. Particularly devastating for badly needed restructuring of state companies was the so-called *popiwek* – a tax on excessive wage increases, restrictiveness of which was evidently overshot. Institutional and social aspects of building a market economy system were underestimated.

Of course, a deep financial destabilization expressed by high inflation rate and extensive shortages,[1] as well as a breakdown of external balance, made the situation more complicated. A short-term hyperinflation was particularly destructive. It was induced by simultaneous liberalization of food prices and irrational, too generous *ex post* wage indexation forced by 'Solidarity'.

At the same time the advantageous for a regime breakthrough starting conditions, due to earlier market reforms and social climate, were quite gainful. Considering the starting point, on the one hand, and serious conceptual errors, on the other, there should be no doubt that the range of transitional recession was much higher than the foreseen. It is obvious that more could have been gained at lesser cost but unfortunately it happened otherwise. Even the then government and its advisors assumed much shorter recession period, faster stabilization effects and prompt general improvement of macroeconomic situation. The gap between the assumed and promised and what was actually achieved was immense. It had far reaching, negative social and political consequences that last even now.

A great success of 'Strategy for Poland'

The second, clearly distinguishing period covers the years 1994–97, when a complex program of structural reforms and fast economic growth had been implemented. A 'Strategy for Poland' continued all the correct strands of transformation that were previously initiated but at the same time it left the evident errors of the preceding period behind. The means of economic policy were not confused with its aims. Neoliberal doctrinarism was abandoned for pragmatic approach based on economic rationalism (Helpman, 2004; Rodrik, 2005).

The taxation of wage increase, based on the growth of labor productivity, was lifted. Commercialization of public sector was implemented, which means that the state-owned companies were exposed to competitive pressure and subjected to tough budget constraints, similarly to the private sector. The process of privatization was rationalized, mainly being submitted to a double criterion: improvement of microeconomic efficiency and maximization of the government revenue.

[1] I have proposed to call such syndrome the shortageflation. (Kolodko and McMahon, 1987).

A great meaning was attributed to building market economy institutions, which resulted in Poland's accession in 1996 to the Organization for Economic Co-operation and Development, OECD. The scope of constitutionally guaranteed independence of the central bank was extended. A system of securing bank deposits was created (Bank Guarantee Fund). Prerogatives of supervision over the capital market were increased and independent insurance supervision was established. Money convertibility conforming to the IMF definition was accepted. First ratings were obtained including investment grade. First foreign bonds were issued. Public dialogue and social partnership were basically different than in the preceding period. A tripartite commission composed of the government, trade unions and business organizations had taken a joint action.

Public debt was radically reduced from approximately 87 percent GDP at the end of 1993 to around 46 percent at the end of 1997. Inflation dropped by two-thirds, from 37.6 percent to 13.2 percent. As regards fiscal policy, investment allowances were applied to foster development. Lowering of taxes was initiated; in particular, statutory decisions were made to reduce taxes for entrepreneurs by as much as one-fifth, from 40 to 32 percent. Actions rationalizing the budget were introduced with simultaneous attributing a more pro-development nature to the expenses. Growing inequality of the distribution of income was stopped and at the end of the period the Gini coefficient was at the level of approximately 0.33 with reference to income and circa 0.29 with respect to wages. The overall social climate improved, optimism of consumers and entrepreneurs grew. Sociological studies emphasize that the number of suicides, which is used to measure the level of social stress, dropped.[2] For the first time during transformation more Poles were coming back to Poland than leaving the country. More than that was assumed in the 'Strategy…' was achieved at less cost than expected (Kolodko and Nuti, 1997).

The success of this phase of transformation has been stressed by many independent authors (North, 2002; Nekipelov, 2004; Roland, 2004; Popov, 2006), including such prominent economists as Joseph E. Stiglitz. Referring to some of our discussions and to certain of my publications (Kolodko, 1998), he writes that Poland owes its achievements to gradual policy of structural reforms and institutional building, what I have proposed (and implemented when being in charge of economic policy) since the onset of transformation. Stiglitz (2002, p. 181) writes:

[2] Distinguished Polish sociologist, Maria Jarosz, states: "…certain particular case of coincidence of events… took place in the second half of the nineties (when Grzegorz W. Kolodko was Deputy Prime Minister and Finance Minister). An extremely spectacular thing happened then: positive economic growth indexes were accompanied by a significant drop in negative social ratios: in 1997 Gross Domestic Product grew … [by] as much as 6.9 (which signifies GDP growth of approximately 82 billion zlotys), and usually increasing Gini coefficient (measuring inequality of income distribution) was at that time halted. At the same time the unemployment rate … dropped to 10.3 in 1997 (that is, unemployment was reduced by over a million people). The above was accompanied by significant temporary reduction of the ever growing suicide rate: from 14.1 to 13.0 (over 400 people less). And even though it is not easy to interpret the above, there comes the reflection over the unusual situation where what should be growing grew, and what should be dropping dropped…" (Jarosz, 2007, p. 14).

> Poland's former deputy premier and financial minister, Grzegorz W. Kolodko, has argued that the success of his nation was due to its explicit rejection of the doctrines of the Washington Consensus. The country did not do what the IMF recommended – it did not engage in rapid privatization, and it did not put reducing inflation to lower and lower levels over all other macroeconomic concerns. But it did emphasize some things to which the IMF had paid insufficient attention – such as the importance of democratic support for the reforms, which entailed trying to keep unemployment low, providing benefits for those who were unemployed and adjusting pensions for inflation, and creating the institutional infrastructure required to make a market economy function.

This is true. Instruments of development policy were not confused with its objectives.

The issue of building social market economy was moved forward as much as it was possible in presence of simultaneous globalization and strong influence of neoliberal trend of the world economic thought and practice.[3] Creating the basics of social market economy in post-socialist countries was difficult due to growing subordination of the economy to impulsive forces of world economy. Also favoring foreign capital by some political and economic elites, which were not interested in strengthening the institutions of social market economy, was of a certain importance. Notwithstanding the weaknesses of economic policy, the main problem is that social market economy is a concept which refers to national economy while it is world economy that is predominant these days.

Poland would have an opportunity to create social market economy if it consequently continued the 'Strategy for Poland' during the last twenty years. Unfortunately, it did not happen partly for doctrinal and ideological reasons and partly due to – as it happens most frequently – subordinating economic policy to group interests imposed on society.

In the context of unquestionable achievements of the years 1994–97 some opinions that were presented as professional forecast, yet expressed rather bad luck wishes, should be reminded here. They announced the 'emerging danger' by former Deputy Prime Minister and Finance Minister, L. Balcerowicz, the phantom of '300 percent inflation,' by former Prime Minister, J.K. Bielecki, or 'national disaster,' by the former representative of Poland in EBRD, J. Winiecki). Unfortunately, in some foreign circles this sinister prophecy had some negative influence on the opinion on Polish economy perspectives. However, thanks to hard facts and rational arguments the situation was soon under control.

Contrary to the defeatism, Polish economy achieved a spectacular success between 1994 and 1997 and at that time it was recognized as the unquestionable leader of post-socialist changes. Also at that time Poland was nicknamed "East European tiger". Regrettably, not for long. The non-orthodox, pragmatic policy,

[3] An important contribution dealing with the influence of neoliberal doctrine on the economic thought and thus on the contemporary world economy is Harvey (2005) and also Kolodko (2006, in press).

which resulted in GDP per capita growth by as much as 28 percent in 1994–97, was foolishly interrupted and the advantageous trends were shortly inverted.

Overcooling and counteracting its aftermath

There came the third phase, the miserable years 1998–2001, when there were attempts to combine the returning orthodox liberalism with 'Solidarity' populism. The results were even worse than at the beginning of the decade. Despite the progress in some sections of the institution building and the quickly extending private sector, economic dynamics faded. As a result of the policy of economy's cooling by the means of fiscal and monetary instruments, the rate of GDP growth dropped from 7.5 percent in the second quarter of 1997 to 0.2 percent in the fourth quarter of 2001. And the rate of 7.5 percent has not been achieved since then. Unemployment, which dropped by over one million people in the years 1994–97, increased by over one million people between 1998 and 2001.

The economy was unnecessarily cooled down, even though it was not at all overheated. There was only certain tension regarding the balance of payment, while until 1997 it constituted no risk. The deficit in the current account in that year was only 3.2 percent of GDP and was in 93 percent financed by the inflow of foreign direct investments, which favored overall situation and improvement of competitiveness of the Polish economy. In 1999 the deficit was already 7.4 percent of GDP. Again, there occurred a perverse effect. As in 1991, contrary to what was intended, high budget deficit occurred after a temporary surplus in 1990, similar to the years 1998–99, instead of lower than in the years 1996–97 current account deficit, two and a half times higher deficit occurred. In 1998 the nominal state budget deficit doubled in comparison to 1997, and in 2000 Poland faced a slump. Apart from 2004, the year 2000 was the only year of significant acceleration of inflation – from 7.3 to 10.1 percent – during the whole transformation period compared to the preceding year (see Statistical Appendix for details).

The above happened when Polish economy was opening to external contacts, grass-roots business was flourishing, microeconomic management was improving, and qualification of personnel was growing. How was it possible? The answer is complex both for psychological and political reasons. As regards the economy it was simple: wrong economic policy was based on wrong theoretical concept. Polish neoliberalism combined with the right wing populism could not result in anything else but impeding the prosperity and driving the economy into stagnation. Social costs of the overcooling policy were enormous and economic effects poor.

As for the political consequences, two parties of the coalition government, neither the neoliberal Freedom Union, UW, nor the populist Solidarity Election Action, AWS, were able in the election of 2001 to receive a minimum 5 percent of votes required to get to the parliament.

Then came the fourth period, years 2002–05. It was the final and key stage of negotiations regarding Polish membership in the European Union. Poland could not stay outside the European Union. Geopolitically it was settled in a broader, European context.[4] However, many important issues – including those relating to fiscal and monetary areas, anti-trust regulations and competition policy, agricultural market, infrastructure and environment protection – were to be negotiated. It was the second half of 2002, preceding the EU summit in Copenhagen, that was crucial. In my opinion at that stage Poland negotiated the maximum of what was achievable. However, concerning the entire, multi-annual negotiation procedure more could have been gained by means of a better coordinated effort of the countries applying for the EU accession.

Apart from advantageous conclusion of negotiations with the European Union and gaining social support for the accession, which ended with the successful referendum in June 2003, the most important result was to pull the economy from the collapse and to direct it again on the path of fast growth. This was both easier and more difficult than similar action after the failed shock without therapy eight years earlier. Easier, since the advancement of the market economy was significant, but also more difficult, as the policy had much less intervention instruments. Those that were still at the government's disposal were used to such an extent that was possible, given the monetary policy of the central bank evidently hindering economic boom. Correcting the errors of monetary policy using fiscal policy moves is not a good modus operandi. Polish economy lost much of economic growth that was potentially possible to achieve due to insufficient coordination of financial policy–monetary policy of the central bank and fiscal policy of the government.

A single, sharp move was made in the second half of 2002 and at the beginning of 2003 in the course of non-orthodox actions. Over 60,000 companies, of which 99 percent were small and medium private companies, were conditionally cleared of debts. According to an opinion of independent centers – for instance the Supreme Technical Organization, NOT – it had saved approximately 210,000 jobs. Saving from unavoidable bankruptcy thousands of companies that were driven to the edge of economic collapse by extensively restrictive fiscal and monetary policies, including excessive currency appreciation favored by the policy of the National Bank of Poland, soon resulted in a reversal of unfavorable trends. Production grew faster and faster, soon after employment started to grow as well. The government budgetary stance and payment balance improved. In the middle of 2003 GDP grew by 4.0, and in the first quarter of 2004 by as much as 7.0 percent. Unfortunately, in 2005 this dynamics was not maintained. It temporarily dropped to 3.5 percent due to general confusion of macroeconomic policy.

Notwithstanding the single debt restructuring and improvement of effectiveness relating to continuous upgrading of business management quality, structural reform and institutional progress connected with preparations referring to the upcoming European Union membership was of great importance for accelerating the rate of growth. With no doubt this part of works of the government and the entire

[4] One may also find some odd opinions that it was the joining of NATO by East and Central European countries, decided by the USA that made their subsequent EU accession possible (Brzezinski, 2007). It is a classical *post hoc ergo propter hoc* mistake, that is, 'after this, therefore because of this', clutched with classical Americacentrism.

machinery of the state was efficient. This facilitated introduction, on an ongoing basis, without waiting for membership, of many institutional improvements.

However, preparing and initiating the implementation of the multi-layer program of structural reforms was of crucial importance. The program integrated and organized activities in many sectors, although its name could mistakenly suggest coordination in only one of them. It was the 'Program of the Reform of Public Finance' (Kolodko, 2004). This package of reforms was not limited only to arranging and consolidating the system of public finance where there was still so much to do and therefore, under different names, it has been continued in the following period after 2005 until present times. This refers also to more than another radical lowering of company taxation, which – after lowering by merely four percentage points by means of decisions made between 1998 and 2001 – were lowered again, this time by nine points from 28 percent in 2002 to 19 percent from the year 2004.[5] It also contributed to acceleration of the growth rate. Though, the most important in the 'Program…' is the proposition of reforming the financing of public services sphere and continuation of reforms with reference to social security. In these fields there is still a lot to do in the following periods.

The years 2006–08 is the fifth stage of the 20-year transformation period. Generally positive economic trends were maintained. Average annual growth rate close to 6 percent was a decent result, although Poland has a potential for a growth rate of approximately 7 percent. With the rate of 7.2 percent income doubles every ten years. It was enough to maintain the dynamics of spring 1997 for the last ten years and GDP would have been not 50 percent higher but twice as high. Recently, that is, in the years 2006–08, this quite good economic situation keeps up not due to the high quality of macroeconomic policy or further improvement of the institutions, but for four other reasons. They are:

- positive inertia of processes initiated in the preceding period;
- noticeable improvement of the quality of microeconomic management at the level of companies;
- development of local governments which supports local initiative and stimulates regional development;
- institutional, financial and investment benefits resulting from the European Union membership, the effect of which may be estimated as additional annual growth of GDP rate of approximately two percentage points.

In the perspective of the following three years – 2009–11 – significant slowing down of production is unavoidable, mainly due to the negative impact of the world economic crisis. On the average, the GDP rate of growth will oscillate around 1 percent. It does not look like returning to the 7 percent growth pattern is possible,

[5] It should be clearly pointed out: of 21 percentage points that were reduced on corporate income tax introduced in the beginning of the 1990-ies at the level of 40 percent, only four points resulted from a decision of the government in 1998–2001. As many as 17 points were decisions made within the 'Strategy for Poland' and the 'Program of the Reform of Public Finance'.

yet if development strategy is correct it still may be possible to reach 5–6 percent annual rate of growth in the second decade of the century (Kolodko, 2005).

And so for about 78 percent of GDP growth achieved during the 20 years of transformation (1990–2009) as many as 47 points happens to be a result of the eight-year period between 1994 and 1997, and 2002 and 2005. The eight-year period of 1990–93 and 1998–2001 is on the whole close to zero. In terms of economic dynamics this is the difference between the ‘Strategy for Poland’ and the ‘Program of the Reform of Public Finance’, on the one hand, and ‘shock therapy’ and over-cooling of economy, on the other (Chart 1).

Thus, the worst policy was being carried out in the four-year period 1998–2001. It was even worse than in the beginning of the last decade although the area of uncertainty was much smaller. It should be once again emphasized that based on incorrect economic theory one may only pursue harmful economic policy. Nothing can justify it. Of course, particular interests of certain lobbies – especially those aiming at cheap access to the assets being privatized (mainly in financial and telecom sectors) and business circles close to the neoliberal media – were of major importance, too.

Different measures of the reforms’ progress and social and economic development

However, the evaluation of transformation progress cannot be reduced only to assessment of economic growth measured by the increase of gross domestic product. There are many more relating processes, both of occasional and long-term implications. Considering the changes in distribution of GDP is not enough either. It is

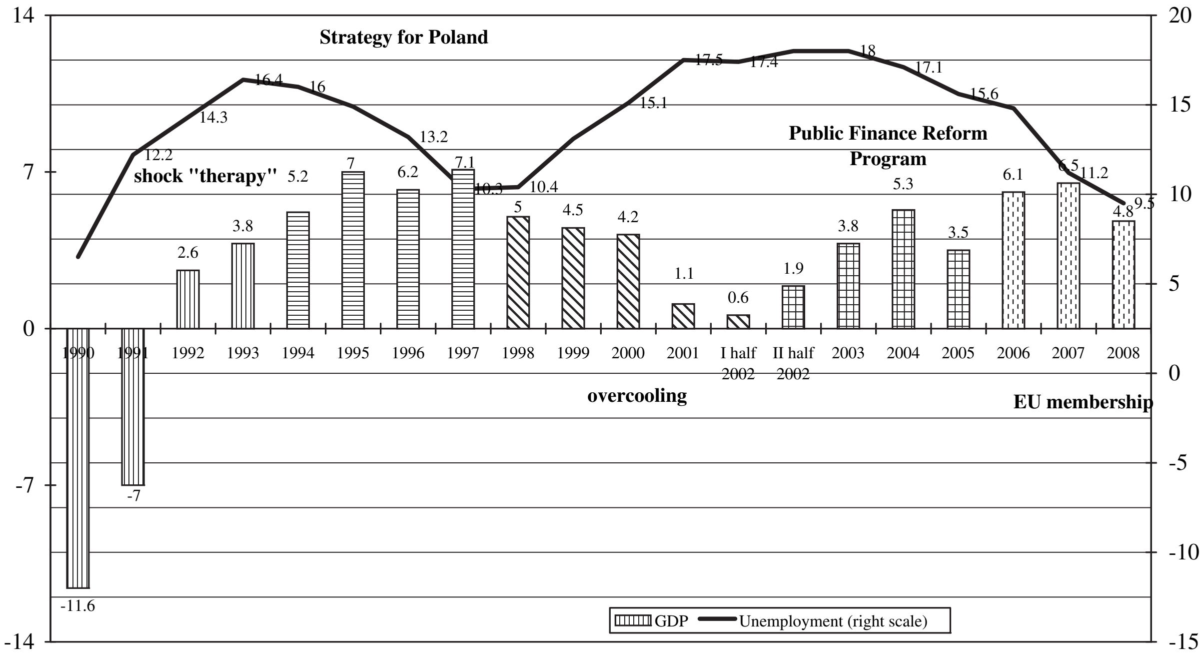

Chart 1. GDP growth (annual percent change) and unemployment (percent), 1990–2008.

true that during transformation irregularities of the distribution evidently intensified. The area of social exclusion was extended, which resulted in doubling the costs. A part of human capital is wasted and additional budget costs must be incurred which pulls them away from being used for pro-development applications. Also in this case the situation worsened largely during the shock without therapy and unnecessary overcooling. The level of inequality seems to be stabilizing over the last few years and, as it can be estimated, the Gini coefficient changes to a minimum extent. Discussion may still refer to whether it was already achieved the level that is turning against economic growth (Tanzi et al., 1999) and how the tax changes shifting a part of income from less well-paid groups to better-paid groups, the so-called ‘flat tax’, proposed by neoliberal circles, would influence its growth.

Recently Poland has been outdistanced by Latvia in terms of the level of income per person. Therefore, Poland, with its GDP *per capita* at purchasing power parity is estimated at approximately 17,200 US dollars in 2008, out of the ten post-socialist EU member states merely comes before Bulgaria and Romania. Polish income corresponds to exactly a half of the average of the entire EU, which in the same year oscillates around 34,000 US dollars. To compare, in the USA it is even a half more: approx. 48,000 USD.

At the same time Poland looks better when we compare its position on the list of a number of countries according to Human Development Index, HDI, compiled by the United Nations Development Program (UNDP, 2008). The highest position belongs to Norway with 0.965, the lowest to Niger with 0.311. Poland with HDI 0.862 was placed by UNDP in the group of 63 states with a high index, no less than 0.800. It is worth mentioning that level 0.800 was also achieved by Bosnia and Herzegovina, with GDP per person at the level of no more than 40 percent of this in Poland. This alone shows how the image of growth changes if we go beyond the quantitative index of gross product and consider, for instance, just these two parameters that indeed are essential for the quality of social capital.

Given the size of GDP per person, Poland comes 50th in the world (taking into consideration UN member states and Hong Kong). Whereas in terms of HDI it comes 37th, between Argentina and Chile. It is a higher position than of the six other post-socialist EU states, including Estonia (0.858), Lithuania (0.857), Slovakia (0.856) and Latvia (0.845), which have a higher GDP per capita. We also leave Bulgaria (0.816) and Romania (0.805) behind. Thus, out of the ten post-socialist EU countries only Slovenia, which comes 27th with HDI 0.910, the Czech Republic (0.885), and Hungary (0.869) are better off.

There comes the question: to what extent this arrangement, so different from the arrangement in accordance with GDP rate, is a result of post-socialist systemic transformation and to what extent it results from general legacy of the previous system? There is no doubt that this time the legacy is quite advantageous. Under the centrally planned socialist economy there was a common public health service. All these countries entered the transformation phase with societies where illiteracy was rooted out already in the initial phase of socialism. Next to common primary education also secondary and tertiary education network was well developed. Positive effects of the above are experienced until our times. By the way, for the same reasons Cuba comes extremely high in the HDI list with the index 0.826 (higher than the neighboring Mexico or, among post-socialist countries, Bulgaria), while its GDP per person is only 4000 USD. Countries with similar average national income, such as Syria or Indonesia, are characterized by the HDI which is over a hundred basis points lower (respectively 0.716 and 0.711).

In the case of Poland, Human Development Index grew in the years of transformation relatively more than in other countries due to a very high increase of scholarization rate at the tertiary level. Dynamic development of private tertiary education – unquestionably relating to transformation – and significant increase of the number of students contributed to the phenomenon. The number of students grew from approximately 400,000 at the beginning of transformation to nearly two million now. Apart from the quality (often very low) of educational offer in many private colleges, almost fivefold increase in the number of students over a period of less than twenty years is a sensation. This fact had a significant impact on HDI growth (Table 1).

It is true that during transformation the human development index grew by more than 100 basic points from below 0.760 to over 0.860 when calculated with the use of methodology that enables comparison. However, the fact is that the main thesis is once again confirmed. During several years of a failed policy of extreme shocks with insufficient therapy in 1990–93 relative position of Poland in the world worsened by as many as a dozen positions. The Human Development Index shows certain growth only in 1993 which is due to bottoming out of crisis and initiating implementation of the governmental program, agreed with the trade unions, called a 'Pact on State Companies in the Course of Transformation'. It was a belated attempt of rescuing quickly deteriorating situation of workers who were unfortunately more frequently jobless due to quickly increasing unemployment. It should be added here that unemployment – so evidently influencing social condition – is not considered by HDI. In the period 1998–2001, when policy leads to miserable results, the growth of HDI – though only until 2000 – is mainly the effect of a great boom of private tertiary education.

In the last year of overcooling the situation deteriorated still further and in 2001 HDI dropped absolutely. It was the only such case during the whole transformation period caused by irrational macroeconomic policy which brought economic growth rate at the end of the year to zero. Four and a half year, and that in favorable external conditions,[6] was enough time to bring growth rate from 7.5 percent to nil. This was a result of inability to coordinate the policy of institutional reforms with the policy of economic growth. They are two policies and under no circumstances in a country maturing to a full market economy actions taken in the first area substitute for those that are indispensable in the second area. These two policies are complementary.

[6] The Russian crisis was of minor importance for Polish economic performance. Its significance was tendentiously exaggerated by the pro-governmental economists, analysts and media. It must be added that the situation in Russia was much worse in 1994–97, but at that time there was no one who would blame closer or farther neighbors for domestic difficulties.

Table 1
Human Development Index in Poland in 1990–2004.

Year	HDI	Comparable HDI (in 1992–96[d])	Position in the world
1990	0.807		43
1991[a]	n.d.		n.d.
1992	0.815	0.765	49
1993	0.875[b]	0.781	56
1994	0.864	0.786	58
1995	0.883	0.796	52
1996	0.886	0.801	44
1997	0.809[c]		44
1998	0.818		44
1999	0.823		38
2000	0.848		37
2001	0.841		35
2002	0.850		37
2003	0.858		36
2004	0.862		37

Source: 'UNDP Human Development Report', 1992–2007.
[a] n.d. – no data.
[b] From 1993 change in calculation method.
[c] From 1997 another change in calculation method.
[d] Indexes for 1992–96 were calculated pursuant to the method applied after the change that was introduced by UNDP in 1997 which enables comparison of the time series 1992–2004.

But neither money nor even growing Human Development Index bring happiness. Interesting research is being carried out at the junction of economy and psychology. It is aiming at defining and measuring of people's moods, in addition to their psychic and physical condition, which is not only a function of income level, education and health. Account is being taken of cultural values, as well as condition of natural environment, level of satisfaction with the method of power exercising and functioning of civil institutions. Comparative studies regarding the field lead to fascinating results based on which the first ever World Happiness Map was developed.[7]

Based on detailed statistical data and multi-subject survey research a compound Subjective Well-Being index, SWB, was created. It is comprised in the range between 100 and 300 (Marks et al., 2006). A hundred and seventy-eight countries (more precisely their nations) were classified in a relevant list. Denmark and Switzerland open the list with 273 points. Just behind are Austria and Iceland with 260 points.[8] The last, with 100 points, comes Burundi, which is separated from Ukraine (120) and Moldavia (117) only by Congo and Zimbabwe (each 110 points).

In the case of SWB the correlation with GDP is significantly weaker than comparing it to HDI. What is remarkable, other post-socialist countries are also ranked quite low in the list, even those which are qualified by UNDP to the group of

[7] The World Happiness Map has been worked out at the University of Leicester (White, 2007).
[8] One can bet that Iceland has lost its prime position in the aftermath of economic turndown of 2008–09.

higher Human Development Index. Lithuania and Latvia come jointly as 154th–155th with 157 points, Bulgaria was ranked 164th with 143 points. Russians are equally unhappy, jointly with citizens of Pakistan and Swaziland. If one believes such research outcome then happiness mainly depends on non-material living conditions. Even though, apart from Bhutan and Costa Rica, the wealthiest nations open the list, further on a stronger correlation with the condition and beauty of nature, as well as tradition and cultural values than income rate is observed. Even Slovenia, which is the wealthiest among post-socialist nations and leads all lists referring to GDP and HDI rates, gets 220 points – exactly the same as poor Kyrgyzstan located in picturesque mountain chains – and is outdistanced by the 57th Mongolia with 223 points (jointly with Fiji and Israel). Behind them there is a place for Poland jointly with Croatia (positions 98–99) with 197 points. Poland is ranked between Iran (200) and South Korea (193). From the group of socialist and post-socialist countries also the Czech Republic (213 points), China and Cuba (210 points each), as well as Tajikistan and Vietnam (203 points each) come before Poland. Kazakhstan (193) and Hungary (190) are close behind Poland.

I have been to all these countries and based on my own observation I cannot say that it is not so; it can be. But it can be neither verified nor confirmed. It would require further interdisciplinary comparative studies. Such studies are extremely attractive. They go far beyond the domain of economy, although Daniel Kahneman was awarded the Nobel prize in 2002 in this field, as he dealt with both behavioral finance and hedonistic psychology. He emphasizes enormous importance of exactly the factors that are considered in SWB estimates in creating social satisfaction (Khaneman, 2003). While keeping distance from the presented results they should not be disregarded. It would be a mistake though on a different level, similar to the one made by neoliberal economy when confusing the means of economic policy with its aims.

What makes drawing of conclusion in the case of SWB index more difficult is the absence of time series and hence the impossibility of comparison in time. Only comparison concerning space may be performed. However, when taking into account individual indexes building up to this collective index it might be assumed that also in this field progress was observed in Poland given a longer time scale. Yet, fluctuation occurs here as well, which seems to be obvious when comparing the optimism of the mid-nineties with the directly preceding and following periods. Similar situation occurred for some time from the second half of 2002. But then again, it did not last too long. Nevertheless, there should be no doubt that during the last few years the level of SWB is burdened with negative opinions on the aspects of political life. Its poor quality, if not absolutely then surely relatively, lowers the subjective sense of social satisfaction of Poles.

The consequences of economic policy mistakes

Some of the mistakes that were made cannot be rectified even in a long time period. A non-generated income is lost once and forever. The only exception from that rule are cases where resignation from current income refers to abandonment of work that generates the income, with simultaneous assignment of time resources obtained in this way to investment in higher labor productivity and production in the future. If one works less and consequently produces and earns less in a given period, but studies more, then the increase of labor productivity achieved in this way may, in the future, compensate with surplus the loss of potential income. If, on the other hand, the idle time is wasted or the time one works is used incorrectly, the loss will be irretrievable.

We are getting closer to the heart of the matter. During transformation a lot more could have been achieved. Also – and from the strictly economic point of view – as regards the level of production and consumption. During transformation Poland missed the opportunity for a much higher GDP growth than the one achieved. It could already exceed the value of Portuguese and be at the same level as in Slovenia or Greece, amounting to over 25,000 US dollars per person. With the level of approximately 17,000 US dollars, it is merely just two-thirds of such amount. A two-thirds of success.

Leaving complicated deliberations and complex econometric models behind, it may be assumed that in the absence of any major exogenous disturbances, important for the course of macroeconomic reproduction process, in conditions of external peace and relative internal peace, it was possible to achieve at least the economic growth rates that had been assumed in government programs. It must be emphasized that the criticism from professional economists circles was mainly limited to claims that growth rate was not sufficiently high and not the other way around. Absence of use of the available potential was indicated. In the final phase of the second period in 1997 an opinion was even formulated that the rate of 7 percent is too low and doubling of GDP within the following 10 years was announced. It was possible at that time just as such ambitious aim could be feasible in the future, though on certain conditions. In particular on condition of consecutive elimination of the infrastructural bottleneck. It is an obstacle but at the same time an opportunity, as infrastructural projects should be, next to export, one of the main flywheels of economic development. Unfortunately, economic policy is a history of missed opportunities.

When looking back it becomes evident that both in the first (1989–93) and in the third period (1998–2001) much higher dynamics indexes had been assumed than actually achieved. At the turn of two preceding decades unrealistic forecast occurred quite often. In particular government economists and their advisors were generous in making optimistic plans. Some of them forecasted a GDP growth by 23 percent (!) in 1991–93, while at that time it dropped in total by 2 percent… (Gomulka, 1990).[9] Forecasts of independent research centers – domestic and foreign – were more

[9] Interestingly enough, the author of such ridiculous forecast was nominated after the election of the fall of 2007 to the post of deputy minister of finance, while another advisor from the period of 'shock without therapy', the one who then tried to ridicule the warning about 25 percent drop of industrial output in 1990, became the minister of finance… So, there is policy and there is politics. And, of course, there is also a feedback between both of them.

balanced, but in most of the cases they also suggested higher growth rate than it was then achieved. Such assumptions were shared in experts' opinions of international organizations, principally the World Bank and International Monetary Fund. Considering their importance and their possibility of putting pressure – much bigger then that at present – their opinions were of great significance. In fact many of these ambitious plans could have been implemented, yet not when applying the economic policy proposed and pursued at that time. Formulating of advice, developing economic programs, and reviewing thereof is one thing, abilities to implement them is another one.

Actual annual growth rates should be confronted with those assumed in governmental programs and those expected by international organizations, as well as renowned experts who monitor Polish economy. This is done by analytical centers, rating institutions, investment banks and research centers. In a simple model for the year 1990 the index assumed by the government was adopted, and for the next three years the index forecast by the then Vice-President and Chief Economist of the World Bank (Summers, 1992) who was in a close working contact with the Polish government was also apparent. For the years 1998–2003 we assumed conservatively almost half a point less than it would result from continuance of the trend of the preceding four-year period, while for the years 1994–97 in the hypothetical variant we maintained the same growth rates as those actually achieved.[10] For the years 2004–08 indexes were taken from the 'Program of the Reform of Public Finance'. Let us note that GDP growth was in fact on the average merely 0.5 point less than the hypothetical and aggregated for the entire period of 2004–08, or altogether 2.4 point less (the difference between the assumed 25.5 percent and actual 23.1 percent growth).

For the entire nineteen-year period 1990–2008 this gives the average annual growth rate of 5.5 percent. Without getting into details, it must be clearly emphasized that such assumptions were strongly supported by reliable economic models and professional econometric forecasts, as in each case comprehensive studies and professional analyses were at the base of indexes used here. In the present times, when until recently, that is until the crisis, the government had assumed for the years 2006–10 and 2011–15 the average annual GDP growth rates of 5.1 and 5.2 percent respectively (Program 2006) based on comprehensive analyses and econometric models. In the past such plans, scenarios and forecasts were also prepared in accordance with the state of art requirements. It refers both to government forecasts and forecast prepared by resource centers. They were supported by a good knowledge of the reality of Polish economy and its external environment. Therefore, if reality is not as favorable we deal with policy errors and not with forecast errors.

[10] 'Strategy for Poland' assumed GDP growth by 21.8 percent in total for 1994–97, which was to be a result of the growth in the following years by 4.5, 5.0, 5.2 and 5.5 percent. In fact GDP grew in total by 6.2 points more and average growth rate (6.4) was higher than the initially forecasted (5.4) by a whole point.

What if…

These forecasts provided the foundations for decisions made by economic agents who trusted them, equally households and companies. Both consumers and investors formulated their own expectations against such forecasts. Consequently, these expectations partly implicated behavior in real economy by initiating economic activities, the flows of income and moves of stocks (Table 2).

To compare, it is almost one percentage point less than the annual average during implementation of the 'Strategy for Poland' or at the level of a half of growth rate in China for the entire period of last two decades. The rate 5.5 percent is also a little higher than that prior to the crisis when the growth rate for the entire world, whose gross product between 2005 and 2008, was growing by almost 5 percent on the average.

It must be added here that this refers to global product growth rate, not per capita. In Poland's case it is more or less the same. More or less, as due to high net emigration in 2005–08 GDP per person in Poland, contrary to most of the countries in the world and contrary to the past, grows on a larger, not smaller scale than in total. In other words, in these years even in case of stagnation in total, GDP per person would go up by the index equal to net migration rate.

Thus, the assumption of GDP growth at an average annual rate of 5.5 percent is not at all unreasonable. It was simply achievable. It was enough to implement adequate growth strategy together with creative policy of system changes throughout the entire period of transformation. Regrettably, due to mistakes that were made, average rate during the post-socialist twenty-year period was merely 3.0 percent. In the beginning of the great transformation such misery regarding dynamics had not been assumed by anybody, especially, since production and living standards grew much faster in the previous epoch, with all its drawbacks. National net income in People Republic of Poland grew annually in the forty-year period 1950–1989 at the rate of 6.7 percent on the average, that is, more than twice as fast as in the twenty-year period 1990–2009. It should be of no surprise that this fact was questioned as part of the negative image of that time. Another issue was that this path of growth was connected with many problems regarding the quality of development process. This is why it was decided to abandon the previous system which resulted in transformation. It is worth saying that also at the time of central planning system there were specific growth cycles. One could observe successive alterations of the phase of acceleration and deceleration of growth rate and the mechanism of such regular fluctuations were of an endogenous nature (Kolodko and Gruszczynski, 1975; Bauer, 1978; Kolodko, 1979, 2002).

Table 2
Actual and hypothetical GDP growth rate in Poland in 1990–2008 (in percent).

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Actual	−11.6	−7.3	2.3	3.5	5.2	7	6.2	7.1	5	4.5	4.2	1.1	1.4	3.8	5.3	3.5	6.1	6.5	4.8
What if…	−3.1	2	5.5	5.5	5.2	7	6.2	7.1	6.7	6.7	6.7	6.7	6.7	6.7	5	5.4	6	7	7

The scale of irreparable losses is great. It is reflected not just by the section separating current income at the level of nearly 180 percent of the level of 1989 from income possible to be achieved at the level of approximately 260 percent of the output level, but the entire field limited by the hypothetical curve of GDP growth from the top and its actual trajectory from the bottom (Chart 2).

Actual gross product per person is by over 17,000 zlotys lower from the one that was achievable. In the conditions of 2008 it is slightly over 30,000 instead of approximately 48,000. However, the loss is much bigger, as negative effects accumulate. Aggregated flows of the years 1990–2008 give a stock in the form of non-generated income, and thus partly unconsumed and partly non-invested, which generates implications for the future, in the massive amount of 5.7 trillion zlotys. It is equivalent to five-year period GDP of 2008, which gives approximately 150,000 zlotys per capita (or rather deprives each person of this amount).

It must be stressed that this train of thoughts holds despite the current world economic crisis. This event has not made in 2008 that much of an impact on the Polish and, for that reason, on some other post-socialist countries. In Poland the GDP rate of growth for this year had slowed to 4.8 percent, yet it was mainly due to the over-appreciation of Polish zloty, and not due to the global crisis. It has hit Poland and other East-Central European economies only in 2009, when those countries were forced into the recession by the external shock.

Now, twenty years after the historic year 1989, the average flow of income per one Pole is 78 percent or so higher. Also for those Poles who were born at that time they

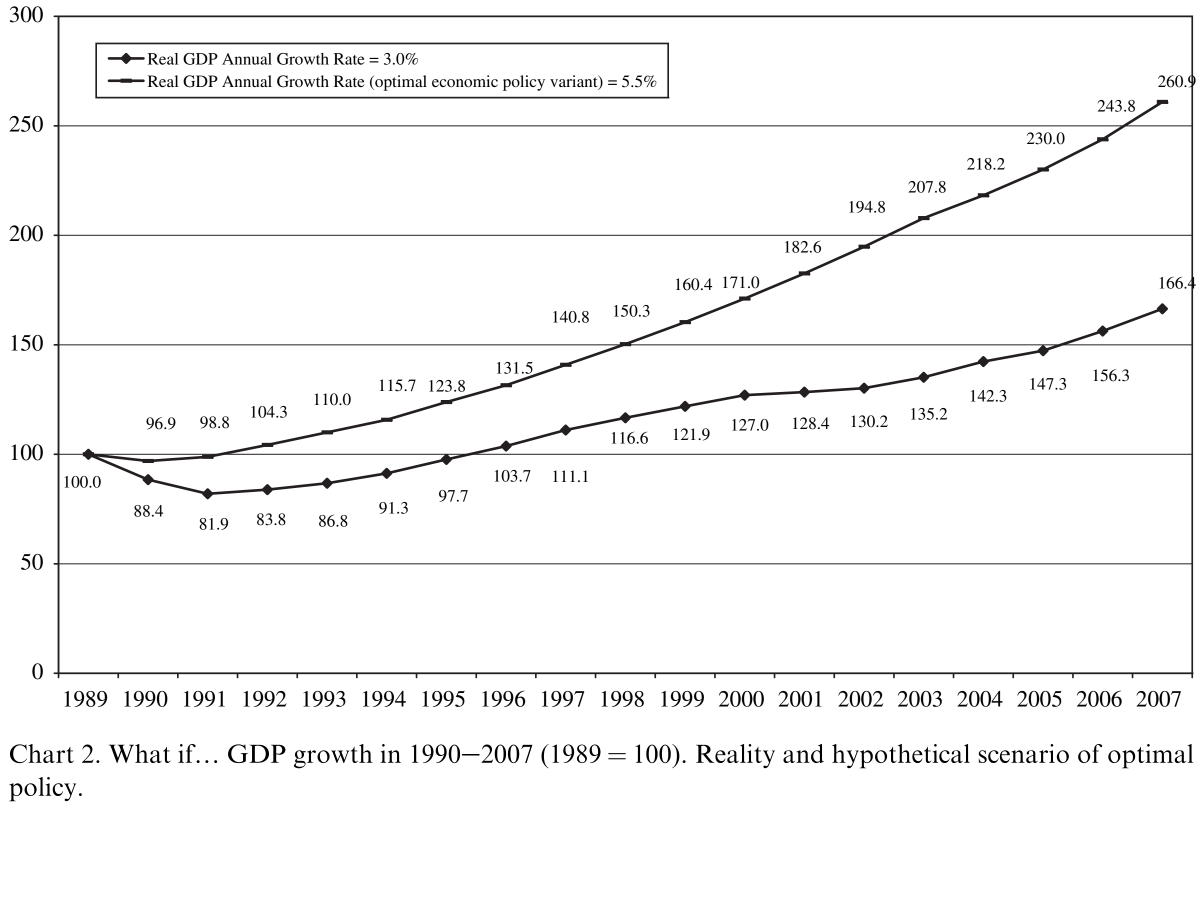

Chart 2. What if… GDP growth in 1990–2007 (1989 = 100). Reality and hypothetical scenario of optimal policy.

are now in graduating classes of the high schools and are knocking on a university door. This is the sign of passing time. It is a pity then that it was not always well used. Because it is not only two-thirds more than one generation before but at the same time merely two-thirds of what could have been achieved. On the one hand we should be pleased – moderately comparing to others and considering the past – with these two-thirds growth, on the other we should be concerned about the wasted one-third that could have been achieved.

In 2008 Polish GDP could already reach around 260 percent of the level of 1989. Perhaps it could be a little more, perhaps a little less. Nevertheless, this is the order of magnitude we refer to. Following the above, Polish economic and political position in the European Union and in the world would have been stronger. International competitiveness of companies would have been higher and so would have been the level of consumption and the standard of living. The quality of social capital and the level of people's satisfaction would have been accordingly higher as well. Whether people would have been happier, that is a different issue.

Conclusions

As the conclusions I would like to propose the seven lessons other post-socialist transition economies and countries of emerging markets should learn from the Polish experience of the last twenty years of the thorny, yet somehow successful road to a free market economy, political democracy and civil society.

Lesson one

Economic reforms that increase the flexibility of markets and at least partially contribute toward the building of institutions necessary for the efficient functioning and development of a market economy always come in handy when a bolder and more profound structural shift is subsequently made. Even if certain reasons – for instance, of political or cultural nature – prevent changing too much at one go, it makes sense to change things little by little, for in time this is likely to bring about the desired results. This is not to say that these partial reforms will gain due recognition later on. Most likely they will not, but that does not change the fact that they did take place and prove helpful for long-term development. Politically speaking, someone sows and someone else reaps the political benefits, but the most important thing is the gain for society, economy and the country.

Lesson two

Only a proper mix of two policies – a system change policy and a development policy oriented toward the accumulation and efficient allocation of capital – offers a chance for a rapid economic growth and sustainable development. Neglect of either of these components precludes good results. Apart from Poland, this is amply demonstrated in a negative sense by the Russian case in the course of the nineties and in a positive sense by China.

Lesson three

Confusing means and ends in economic policy backfires, increasing the social costs of development and decreasing its attainable scale. This sin was rampant not only in Poland and was not restricted to any specific periods: mixing up policy goals and instruments is a widespread phenomenon in modern world. As the means become glorified, they sometimes come to be perceived as ultimate goals, as was the case in Poland in the late 1990s, driving the economy to stagnation. That effect occurred despite the progress in institution building, privatization efforts and the ongoing process of opening up the economy.

Lesson four

At the time of a great systemic transformation – in which the liberalization and opening up of the economy go hand in hand with its integration into the global system – institution building, that is, the creation of new rules of the market economic game and a legal and organizational framework for their implementation, is of a fundamental importance. But policy is also vital. Ever improving institutions do not by themselves entail – at least not in the short-term perspective – an ever improving policy. The latter may be, alas, steadily deteriorating, for it also depends on other factors, such as the economic doctrine, the dominant political set-up and the skills (or their lack) of those who run the economic policy. Institutions matter, but so does policy.

Lesson five

The main source of development financing in all types of so-called emerging markets has been and is domestic capital accumulation. Therefore, the formation of this capital should be given the priority it requires in the macroeconomic policy and in the system of microeconomic incentives. What is important, in particular, is the appropriate design of the financial – both fiscal and monetary – policy, which significantly affects the marginal propensity to save and thus has a fundamental influence on the overall rate of capital accumulation and the investment level and dynamics. One can count on others to a limited degree only. It is best to count on oneself.

Lesson six

Globalization, which is unavoidable and seems irreversible, creates additional development opportunities and additional development challenges. Therefore, the art of economic policy-making consists today in the apt handling of the dilemmas that crop up under the new circumstances. The mini-max rule should be followed:

minimize threats, maximize opportunities – or, more precisely, reduce the inevitable costs of participation in the global economic game and increase the benefits thereof.

Lesson seven

Economic policy is at the same time a technocratic and social endeavor. The neglect of either of these aspects automatically decreases the effectiveness of the policy. It is not enough that narrow groups of experts know what to do. Such knowledge must be shared by broad circles of society, although it then becomes a different knowledge. Therefore, the best results in economic policy are provided by an appropriate mix of financial and social engineering, technocratic macroeconomic governance and genuine social dialogue, professional pragmatism and social sensitivity.

In short, there is a true need for a new pragmatism.

Statistical Appendix

See Charts 3–13,

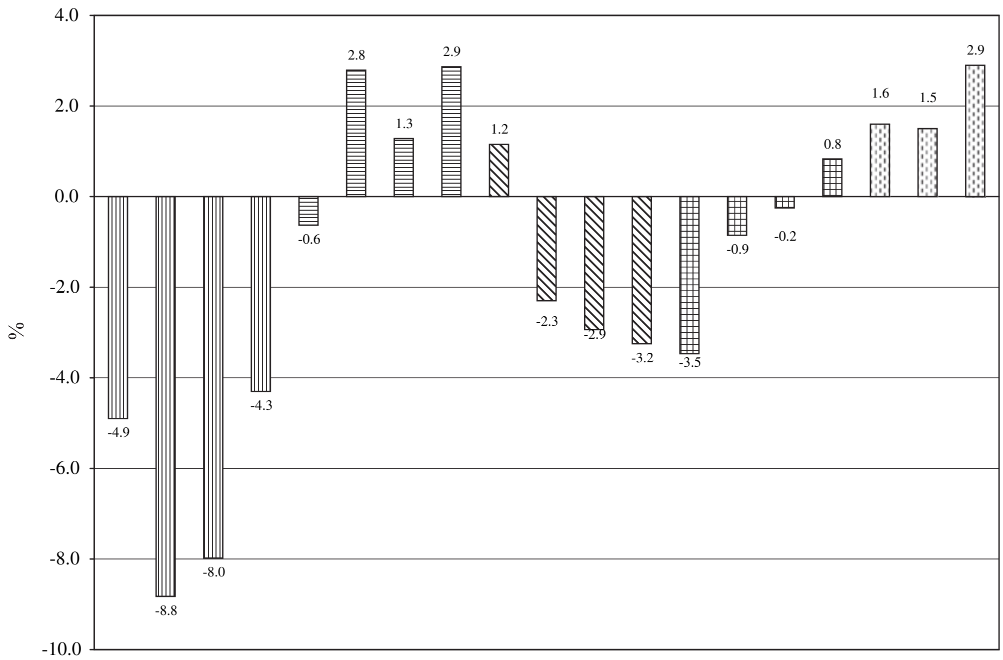

Chart 3. Employment, 1990–2008 (annual percent change).

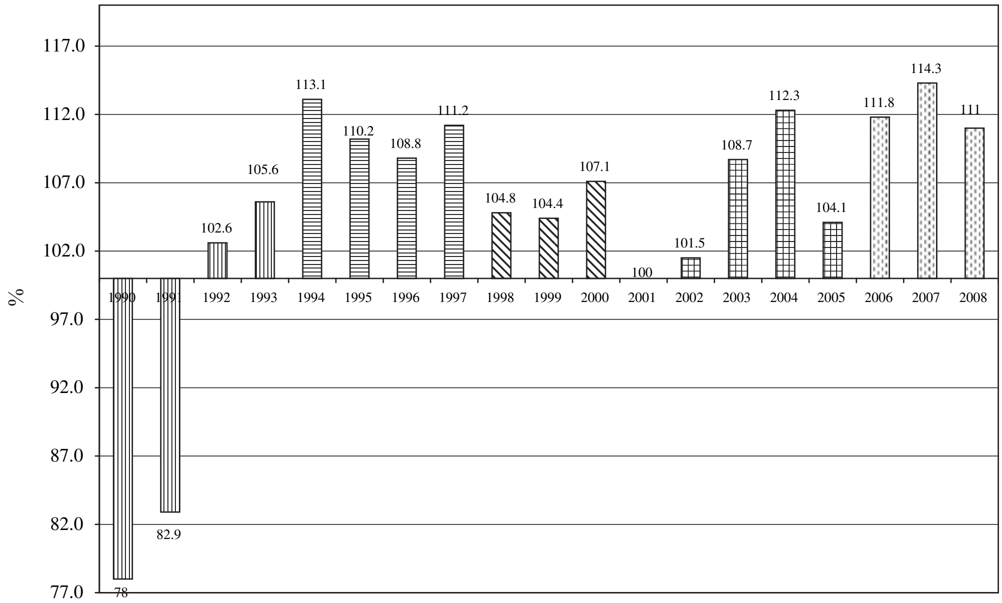

Chart 4. Industrial production, 1990–2008 (annual percent change).

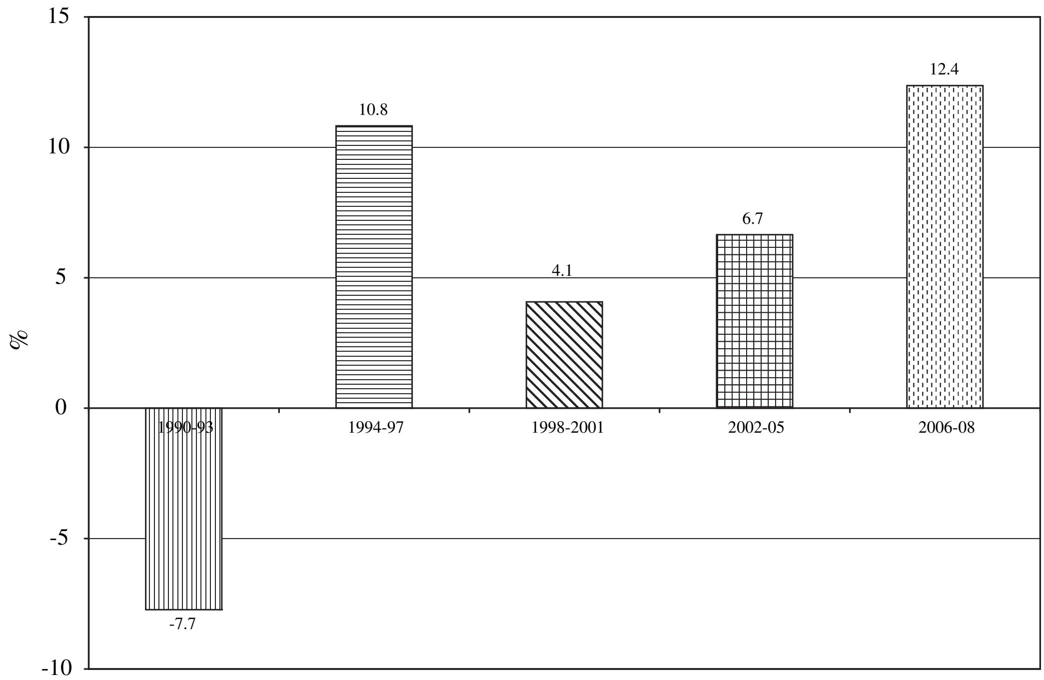

Chart 5. Industrial production growth in successive periods, 1990–2008 (percent).

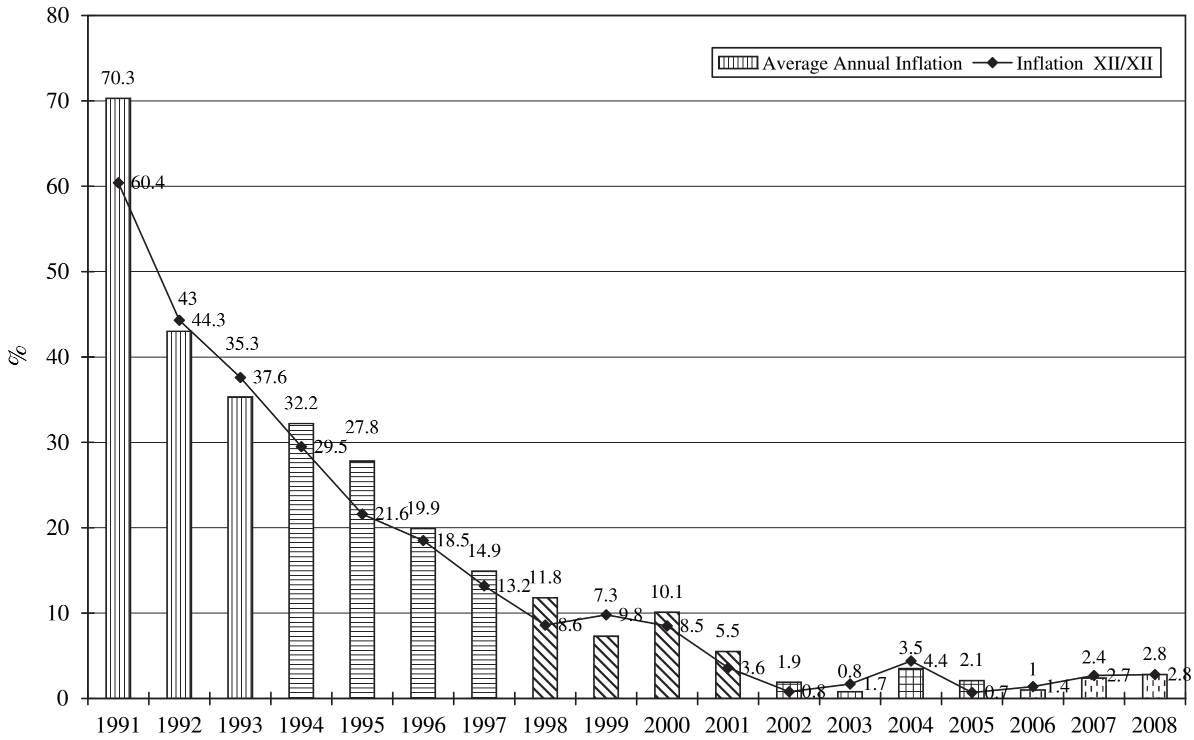

Chart 6. Consumer prices, 1991–2008 (annual percent change).

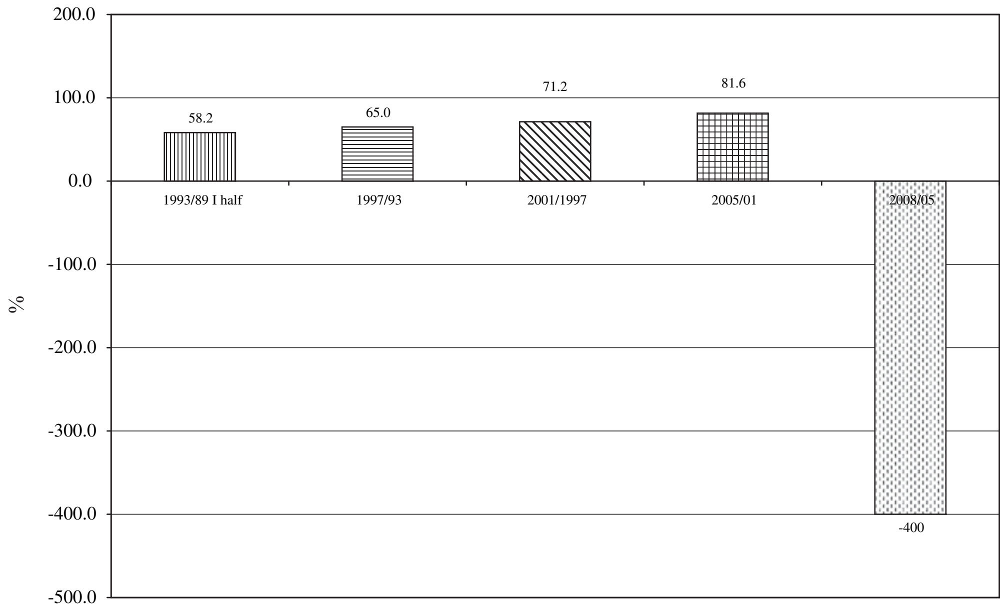

Chart 7. Inflation reduction at the end of successive 4-year periods, 1989–2008.

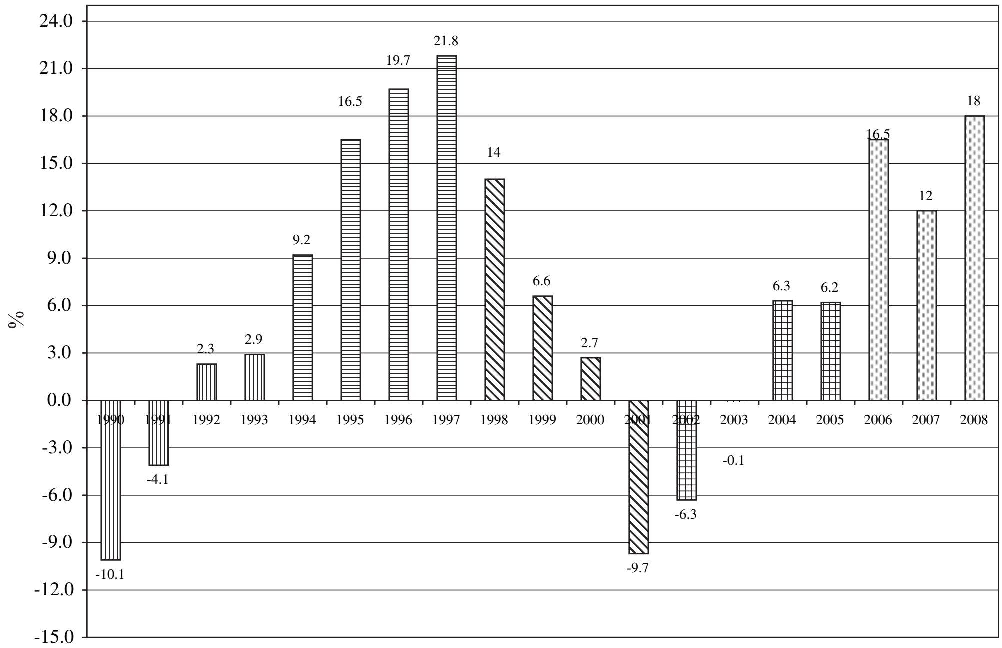

Chart 8. Investments, 1990–2008 (annual percent change).

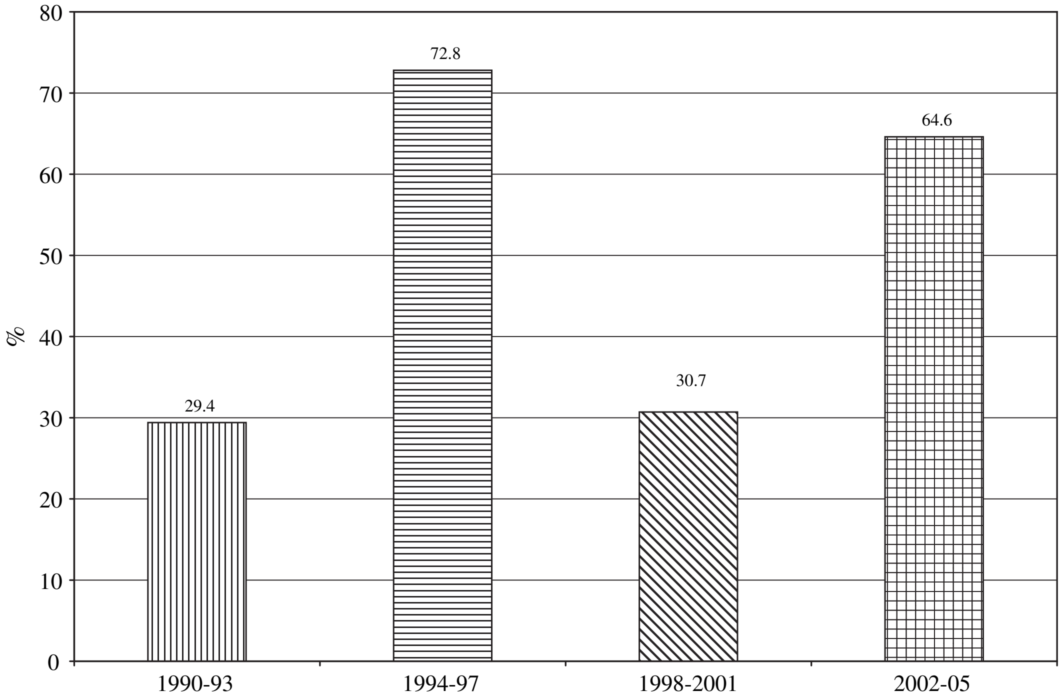

Chart 9. Cumulative export growth in successive 4-year periods, 1990–2005.

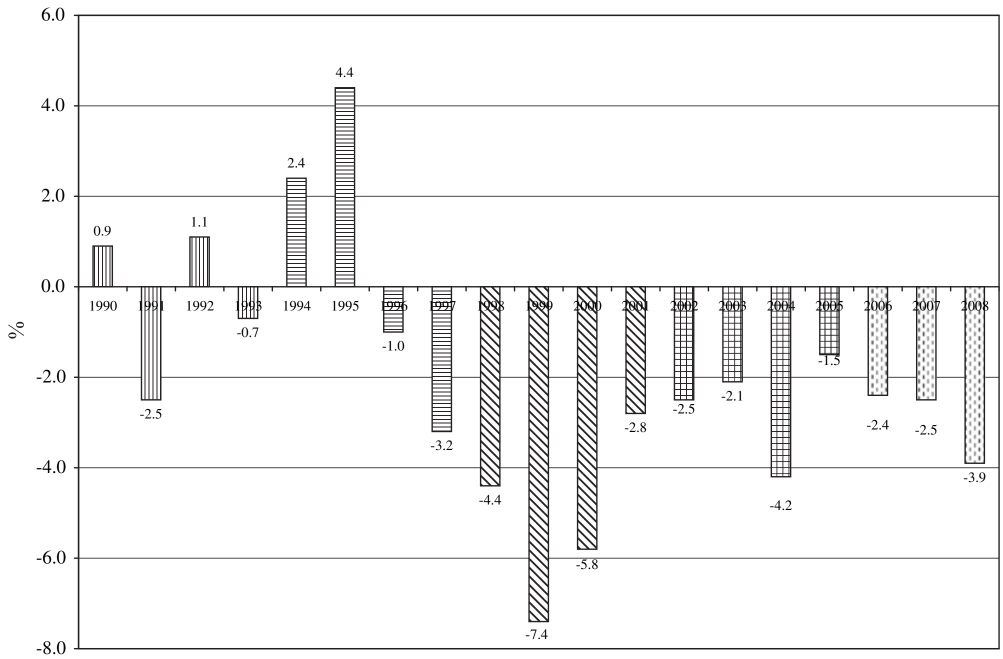

Chart 10. Balance on current account, 1990–2008 (percent of GDP).

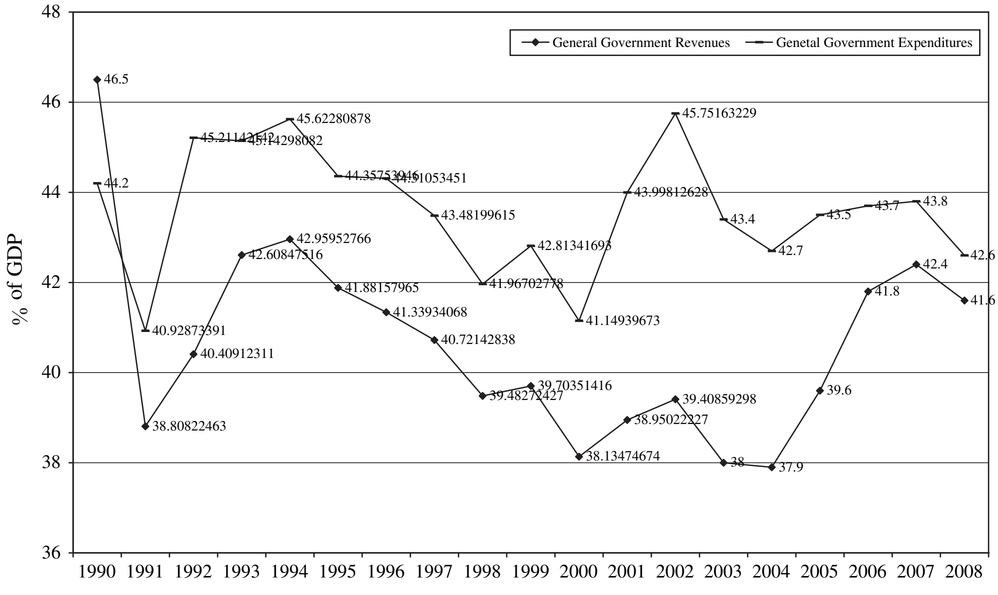

Chart 11. General government revenues and expenditures, 1990–2008.

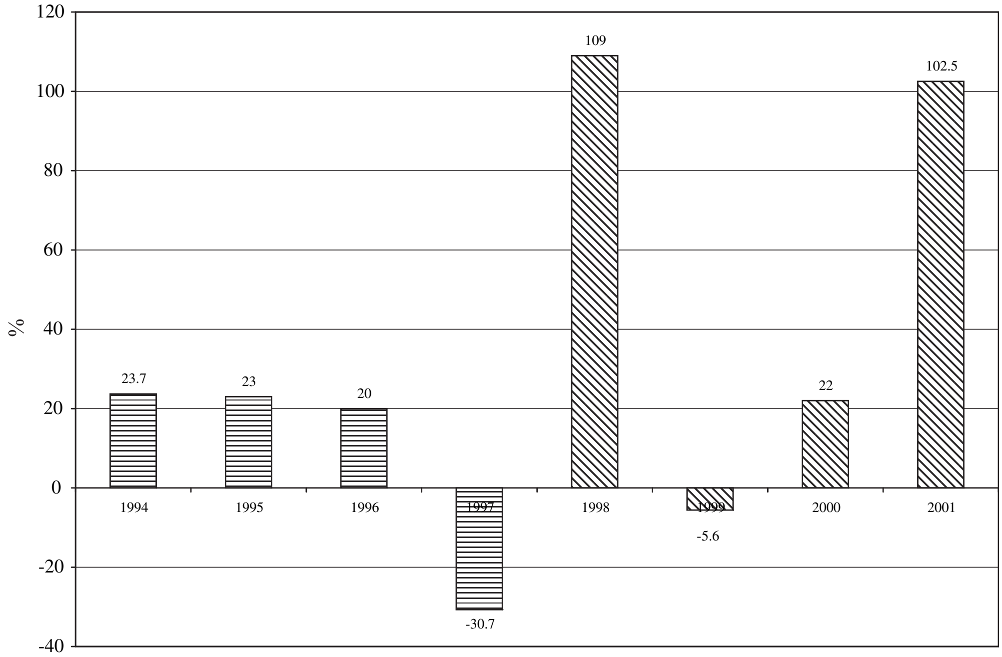

Chart 12. Real general government debt growth, 1997–2001 (annual percent change).

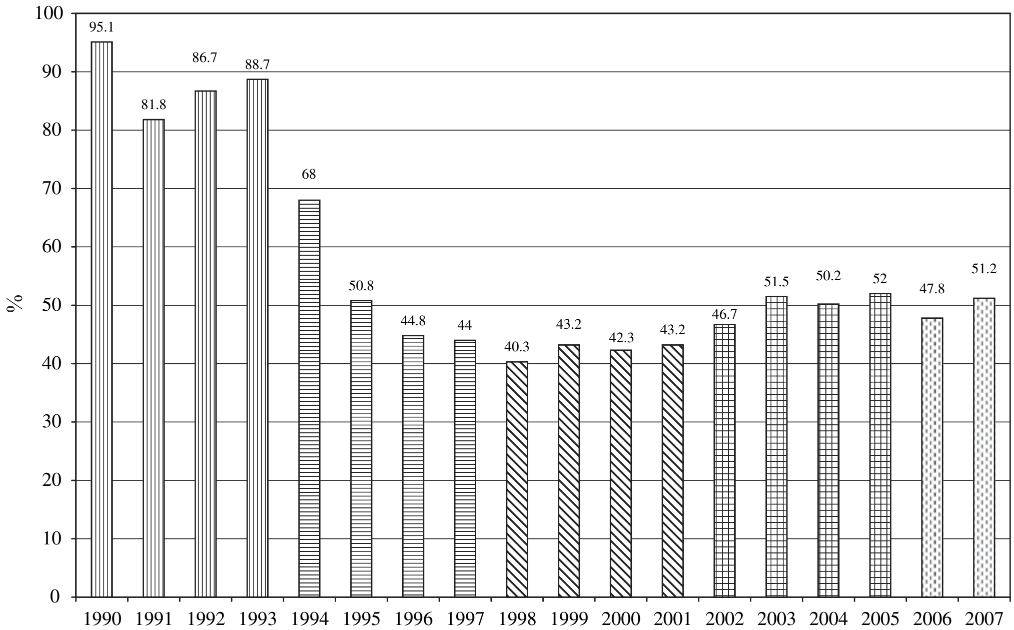

Chart 13. General government debt, 1990–2007 (percent of GDP).

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