

ECONOMIC CHANGE AND SHORTAGEFLATION UNDER CENTRALLY PLANNED ECONOMIES

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1. - Introduction

One by one socialist countries are entering the road of radical economic reforms. This transition hasn't been so far adequately studied nor described in literature. This shift implies a major overhaul of the operation of the whole economic system, consisting in the limitation of directive management and in expanding the field where market forces can operate. When market-type relations embrace broader areas, market-related categories also become increasingly important. Moreover, many processes which previously had a different form, or were non-existent, come to surface or are intensified.

Inflation in its price form is such an example. This phenomenon could be observed earlier, but its essence, scope and intensity, both with respect to the causes and mechanisms, were different from what surfaces in market-like environment.

2. - Determinants (and Barriers) of Economic Reforms

The configuration of domestic economic, political and social factors, different in the respective countries, is the main determinant of economic reforms in socialist states. It has been observed long ago that growth opportunities offered by the traditional centralized and bureaucratized management system were near exhaustion. These observations usually gave way to statements about the necessary transition to a new growth stage, described as intensive growth. However, no centralized economy has achieved this stage thus far and they are still dominated by extensive growth. In some of the countries one can observe stagnation, due to the exhaustion of extensive growth factors.

Intensive growth factors, especially scientific and technological progress, can be tapped only through economic reforms. Given their different domestic social, economic and political situations, socialist countries differ in the timing of their economic reforms. The general trend in economic reforms however, seems already clear: they will consist in the further «marketization» of economic relations.

There are at least three reasons to expand the scope of market-type relations and to further develop them. First, the marketplace is a vital source of information about social needs¹. After all, their optimal fulfillment is the professed goal of production in socialism. It is also obvious that it cannot be the production goal on the microeconomic scale. Actually, the main objective of economic reforms, apart from stimulating entrepreneurship, is to devise a mechanism capable of harmonizing the goals at different levels of the economy. The lack of market information hinders the proper allocation of production factors - labor and capital -

¹ KOLODKO [1986] AND [1987C].

and entails all the inevitable structural consequences. Second, there is the objective necessity to strengthen the role of money and related categories, to check excessive investment, which has so far been an inherent feature of all socialist economies. Third, developing the marketplace promotes entrepreneurship and spurs initiative.

It is obvious that the scope of influence of the central plan must be correspondingly limited, which will diminish the influence of certain power elites, connected with traditional economic management. Central planning, however, must remain an integral element of the new economic system, parallel to the market. First, the central plan should continue to rule certain basic economic proportions, especially the final distribution of the national income between consumption and investment. Second, it must remain an active instrument capable of bearing on macro - and micro-economic structural changes. Third, central planning should have a say on the overall trends in scientific and technological progress. Lastly, participation in the international division of labour should be subjected to central planning.

Finding the right proportions between the market and the plan, as two parallel regulatory subsystems of the national economy, is a challenge for real socialism for several decades to come. Though it is certain that the economy should be made more market-like than it has ever been before, there are more uncertainties about the directions and pace of this process, than it is generally believed. On the other hand, one must be fully aware of the dangers involved in extending the scope of market-type relations. Some of these had never come to light under the traditional directive-type management, others were present but on a different scale. Thus, the point is to create an economic system where control over reproduction will not be the exclusive preserve of «the invisible hand of the market» or of the central planner.

Three fundamental requirements must be met for economic reforms to succeed. First - reforms need social approval; second - the authorities and politicians must be willing and determined to implement certain systemic changes, including the self-limitation of their power and third - economists should know what needs to be done. Though economists' knowledge about these matters is increasingly broad, one may still have doubts whether there actually is a viable vision of how the socialist economy should operate and whether there are the means for implementing this vision.

As goes for the first two requirements, situation differs in the respective countries. Social approval has declined in Yugoslavia, Poland and Hungary. The situation in China and the USSR differs. This is quite understandable, since Yugoslav, Polish and Hungarian populations have already had to bear the costs of economic reforms, while the Soviet Union is only paving the way, conceptually and politically, for changes which will alter the operation of its national economy and for their consequences. China is a case apart, calling for a different approach, which is why it will not be considered here.

Lastly, the authorities seem to have the political will to go ahead with reforms, though insufficient determination, avoidance of clear-cut solutions and postponed decisions are a source of concern.

3. - Opening or Stimulating Inflation?

Opening inflation could appear as one of the preconditions of successful economic reforms. This approach assumed that following certain adaptative processes, inflation would remain at moderate levels. This was to happen thanks to durable improvements in overall

productivity and the elimination of excess demand of the pre-reform era. Time proved otherwise. Thus, the thesis that economic reforms only open inflation, replacing shortages with open price inflation, calls for verification². It is important, because countries which have progressed with economic reforms, found long-lasting and high inflation unavoidable. We thus come to the question: Can countries which now initiate economic reforms avoid the same fate³?

The analysis of experiences connected with reformatory activities in socialist economies leads clearly to the conclusion that reforms have been essentially pro-inflationary. Countries making a broader use of market instruments were faced with a rapid rise in inflation rates (measured with the consumer price index)⁴. The explanation is quite straightforward. Increased reliance on market-type instruments combined with excess demand, triggered-off cumulative price increases. Given the lack of built-in barriers capable of preventing the transmission of price rises to the costs and revenues of various economic organizations, this impact proved to be an «inflationary shock» as if it were, which was not eliminated later.

The lack of tight-money⁵ policies produces a situation where money plays a passive and secondary role with regard to real processes. Money supply is adapted to these processes and not the other way around. Thus, despite a liberal approach to pricing, demand continues to outstrip supply. Now, since in nominal terms more is distributed than produced, the translation of the national income into real terms is done via price inflation, with all the consequences for its redistribution, which - owing to the nature of inflationary processes - cannot be fully controlled.

Not even in the reformed economies however, including Yugoslavia and Hungary, is the operation of the market mechanism complete. Pricing remains state-controlled by administrative and political methods. Thus, what these economies actually face is a situation worse than before the reforms, i.e. shortageflation manifested in the coexistence of price inflation and shortages. Shortageflation rate estimates (annual rates) for the 1977-84 period for the CMEA countries were the following⁶:

<i>Country Shortageflation</i>	
	(% rate)
Bulgaria	6.9
Czechoslovakia	5.1
GDR	3.1
Poland	29.4
Romania	8.3
Hungary	8.9
Soviet Union	4.6

² KOLODKO [1982].

³ I disregard here the issue of worldwide inflation and its impact on inflation in socialist economies. For more on these issues refer to, among others, RACZKOWSKI [1984] and KOLODKO [1987b].

⁴ To exemplify we can cite figures for Hungary. Since 1946 - according to the data provided to the author by the Hungarian Price Office - prices increased approximately sixfold. Thus, the forint's purchasing power by 1985 had dropped to 16.5% of its 1946 value. In this 83.7 percentage point slide, only 5.7% points are attributable to the 1953-1974 period, while the 1975-1985 period is responsible for three times more. The remaining 62.3 points result from price rises in the 1946-1952 period, when prices increased by more than 165%.

⁵ KORNAI [1980].

⁶ The indices and estimation methods are presented in KOLODKO and McMAHON [1987].

The scale and make-up of shortageflation differ from country to country, as their price inflation rates and shortages differ. *It appears that shortageflation is a transition stage to reformed socialist economy* and will persist until these countries have solved structural problems which - in conjunction with the deficient economic system and economic policy mistakes - are the sources of inflation.

Let us remind, that stagflation - inherent in contemporary capitalist economies since more than a decade - is a cost that these economies are paying for structural adaptation, connected mainly to two «price shocks» (1973 and 1979)⁷. Likewise, shortageflation is a cost to be paid by the socialist countries, maybe also for more than a decade. These are the costs of adaptation to new, different economic conditions. This payment has been deferred for quite a time in some cases, but cannot be postponed forever. Economic reforms or, more precisely, specific instruments of the new economic and financial system used in these reforms, can either multiply or reduce these costs, but cannot eliminate them altogether.

Looking at *shortageflation as a peculiar analogy with stagflation in the capitalist economies*, one inevitably comes to the question of the choice between open or repressed inflation in the implementation of economic reforms⁸. The point is that real-life social and economic mechanisms *no longer* permit to fully repress inflation, but do not *yet* permit - mostly for political and social reasons - turning to an open price inflation. Given the financial and economic mechanisms implemented thus far, especially with regard to investment, wage, income and credit policies, featuring the «soft budget constraint», shortages are bound to persist, along with various leftovers of the former management system - mostly various forms of rationing.

There no doubt *remains the short-term choice between various price inflation and shortage rates*. Higher price growth equals lower shortages and vice-versa. This view has not yet been recognized by all authors⁹. They believe that the inflationary alternative, i.e. the choice presented above, is non-existent. Whether or not the problem of choice in this area is resolved, the dilemma which had created it in the first place, remains there¹⁰. In the long term however, this alternative loses its importance, due to the inflationary spiral in the reformed national economy: persisting shortages are replicated at ever higher price (and income and cost) levels.

Drawing on Yugoslav, Polish and Hungarian historical experiences one can say that *inflation has become one of the main barriers to the implementation of economic reforms*. When reforms were launched it was generally believed that more realistic pricing, i.e. prices reflecting production costs and the supply/demand balance, would facilitate and accelerate the overhauling of the operation of the national economy, it is now recognized that this process lives a life of its own and constitutes a threat to reformatory efforts. In other words, inflation has not become an instrument facilitating necessary adaptive processes; instead, it turned into one of the fundamental barriers. This barrier is visible at all levels: economic, social and political.

⁷ BRUNO and SACHS [1985].

⁸ See KOLODKO and McMAHON, op. at.

⁹ Kornai [1982], and Oles and Sumlinski [1986].

¹⁰ «...the inflationary alternative does not exist as a choice function on which economic policy could be founded. The alternative was real only when the decision was to be made, whether to rise prices or keep them at a constant level». See: OLES and SUMLINSKI, op. cit., p.2.

4. - Economic Aspects of the Relationships between Economic Reforms and Inflation

Volumes have been devoted to relationships between inflation and economic growth, without however achieving unanimity on the subject. Authors generally agree that beginning with a certain rate, inflation becomes an obstacle to economic growth. This rate however, differs in time and place. Moreover, things look different in socialist economies, where inflation - especially in its repressed form¹¹ - is one of the methods of achieving higher investment rates and of financing additional investment¹². Without getting involved in the details, one must say that excessive inflation rates observed in Poland and Hungary in the recent years have contributed to a relative depression of economic growth (Figg. 1 and 2). The same can be said about Yugoslavia (Fig. 3). The reason is not inflation itself, but the fact that it is long-lasting and because its rate is relatively high. Repressed inflation is even more detrimental to economic growth.

The negative impact of macroeconomic inflation can be analyzed, among other ways, in the light of microeconomic behavior. We shall concentrate here on the phenomenon which could be called the *shortageflation syndrome*, which is detrimental to both productivity and equilibrium and thus -clearly harmful for the goals of economic reforms. This syndrome consists in the fact that companies operating in the social, economic and institutional environment created by economic reforms are not interested in achieving equilibrium prices; neither through increased output and supply (which is less surprising) nor by way of price increases, which is surprising indeed¹³.

Even when there are no administrative price controls and no social or political oppositions to price increases, companies rise prices, but not enough to achieve equilibrium. They rely on a cost-plus-margin formula, locking-in a certain profit they find satisfactory. Under rapidly changing market conditions one should expect frequent stepwise upmarking of the prices of production factors. Companies operating on the cost-plus-margin principle then increase prices for their products, compensating for increased costs and remain at the same level of profitability. If they had earlier gone nearer equilibrium prices, then defending the current profitability level would have called for improved efficiency, mostly through cost reductions or increased output.

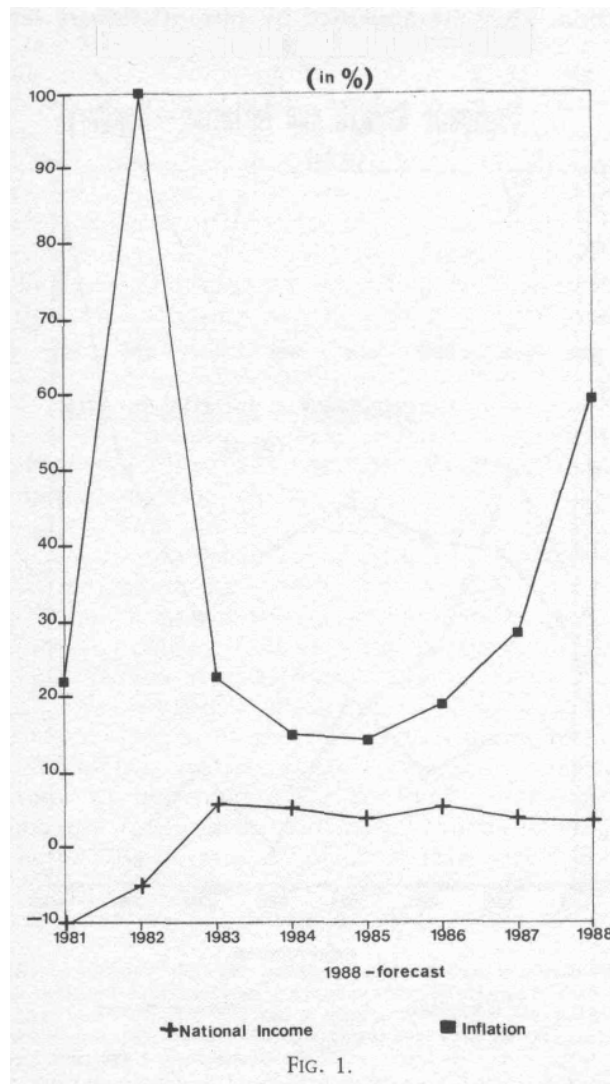
When excess demand is perpetually increased by the inflationary spiral, it is hard to run into limitations from this side, i.e. sales problems. On the macroeconomic scale, expenses equal receipts. If there are no savings, which is a frequent case when high inflation rates are anticipated, then additional demand is created. It cannot be fully satisfied even though companies keep on rising their prices.

¹¹ CHARLESWORTH [1955].

¹² KUCHARSKI [1972], and BEKSIK and LIBURA [1974].

¹³ I refer here to the so-called «free» prices which can be in principle agreed between producers and their buyers, though they are often subject to various limitations. According to the principles of economic reforms, these prices should be set basing on the demand/supply balance, i.e. they should be equilibrium prices.

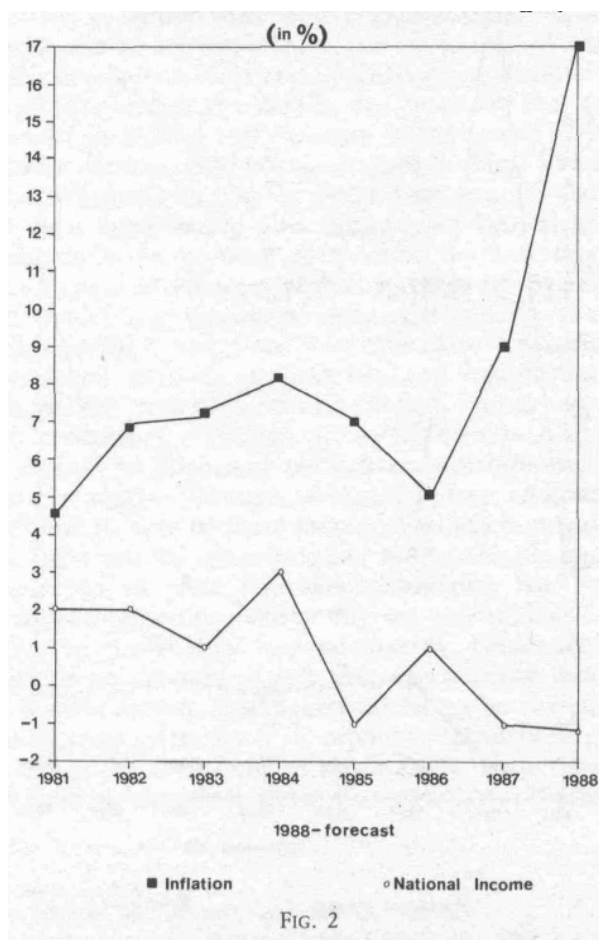
Economic Growth and Inflation - Poland



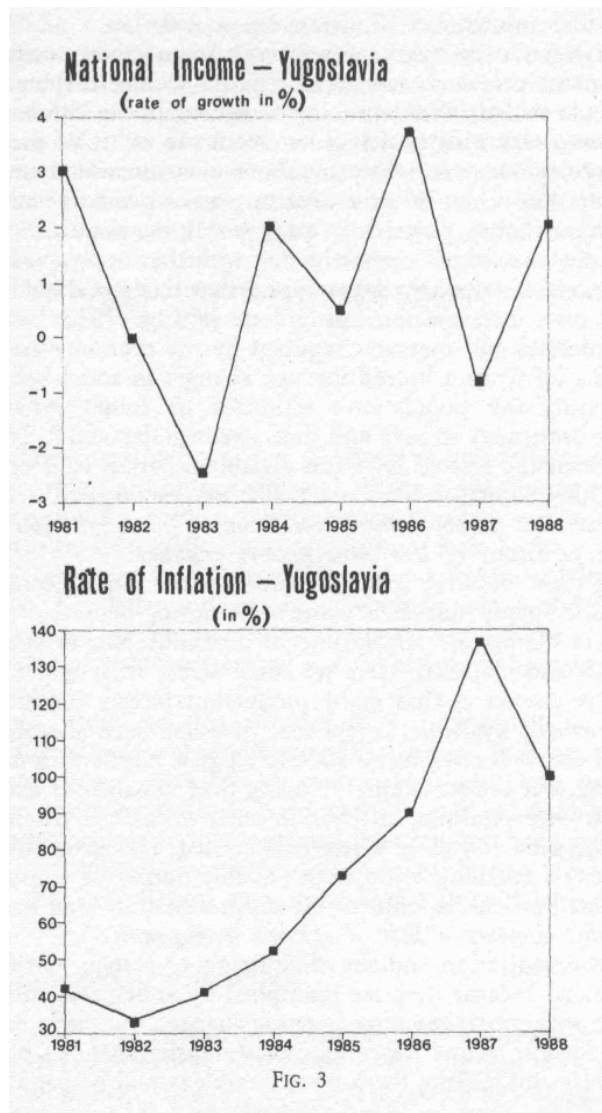
SOURCE: *Statistical Yearbook*, Central Statistical Office, Warsaw, various issues. Data for 1988, preliminary own forecast.

If this is the process that we are really facing, then economic policy should stimulate producers to rise their prices to levels where supply and demand would be balanced, while financial equilibrium should be ensured by proper monetary and fiscal policies. What can be now observed in our social and economic environment, however, are measures aimed in the opposite direction. They are underlied by anti-inflationary sentiments but generate inflationary effects and - most of all - they contribute to the persistence of the mechanism of demand-pull inflation.

Economic Growth and Inflation-Hungary



Source: For Y (National Income) - *Statistical Yearbook*, Central Statistical Office, Warsaw, various issues. For rate of inflation - *International Financial Statistics*, International Monetary Fund, Washington, DC, May 1985 and May 1988.



Source: Y (National Income): 1981-1983 *Statistical Yearbook*, Central Statistical Office, Warsaw, 1982, 1983 and 1984. For 1984-1987: *Economic Survey of Europe in 1986-1987*, United Nations. Economic Commission for Europe, New York 1987, pp. 57-58. *Rate of inflation: International Financial Statistics*, International Monetary Fund, Washington, DC, February 1984 and August 1987. Data for 1987 provided by the National Bank of Yugoslavia. For 1988 - own forecast.

These strategies used by the firms result in macroeconomic shortages, which cannot be accurately estimated. There is enough evidence however, to demonstrate that these are meaningful figures, in the Polish economy at least. Without concerning ourselves here with the utility of the concept of «inflationary overhang» for analyzing the market situation¹⁴, one can assert that between 1982 and 1987, this overhang was equal to 15-30% of Polish population's purchasing power¹⁵. In other words, the population has a definite excess demand, which cannot be met with the supply available at current price levels. It would therefore appear that this gap should be bridged by dramatic price increases or quantum leaps in supply. This however is not the case. Processes and measures required by the economy are one thing, but there is a lot to be achieved through changes in social behavioral patterns. Lowering the

¹⁴ TOPINSKI [1986].

¹⁵ For more on this subject, refer to, among others, KOLODKO [1987a], PAJESTKA [1986], and GORSKI and JEDRZEJCZAK [1987].

population's estimates of future inflation, could increase the propensity to save and thus - reduce demand¹⁶. This however is impossible in the face of high and variable inflation rates or with acute and long-lasting shortages. This is actually another negative feedback: *persisting inflation rises the population's expectations of future price hikes and contributes to the persistence of this unsatisfactory situation.*

Reversing these negative trends however, would require certain definite stimuli on the supply side. It is worthwhile noting here, that shortages in the consumer market are largely due to disequilibrium in the market of capital goods and materials. Here we come across what might be called a *shift effect*. Its essence is that many production factors currently in short supply are actually available, except that they had been allocated to other, not optimal uses¹⁷. It resembles a 100-piece jigsaw puzzle with only one element missing, but the remaining 99 being thus unbalanced and shifted to «other» positions - nothing matches. In other words, everything is in short supply, at the time and place where it is needed. This gives rise to numerous bottlenecks, entailing lower than possible output of consumer goods. Clearing these bottlenecks calls for the *elimination of the most serious shortage of the socialist economy - that of efficient management.*

Improved organization and the elimination of certain «artificial» shortages - artificial because they are multiplied by anticipated inflation - are not possible without far-reaching systemic changes, especially in the allocation of production factors. Opening capital-transfer channels between various companies and making them more flexible would be particularly helpful, since there can be no efficient balancing mechanism in the consumer market, without a balanced capital market. It will remain impossible unless the «marketization» of economic relations is pushed farther still, i.e. including the creation of a labor market. It is obvious that the development of these markets will have far-reaching consequences - unfortunately also the negative ones - for the operation of the whole national economy and for the population. Also, it is worthwhile to realize already now, that setting up such markets will not solve any problems on its own. There is ample proof to support this statement: Hungarian experiences, despite a balanced consumer market and a hatching capital market; Yugoslavia, where inflation persists and the economy is in the doldrums despite already operating capital and labor markets (14% unemployment rate).

5. - Social Implications

Natural differences in the living standards of the respective social and professional groups are further widened by the redistributive effects of inflation. Redistribution applies to both current incomes and to accumulated consumer wealth. Eventually, changes occur not only in the proportions of households' consumption financed with current revenues, but also in real consumption. The latter includes also the consumption of formerly accumulated consumer wealth, the consumption of free services offered by the state, the value of transfers received and the results of households' production and services¹⁸.

Regrettably, there are no estimates of real consumption and of its changes in the proportions in different social groups. Fragmentary information however, shows¹⁹ that differences in households' living standards also widen under shortageflation. It is worthwhile

¹⁶ OLES [1985].

¹⁷ This is most visible with regard to labor, where the deficits persist, though there actually should be a surplus.

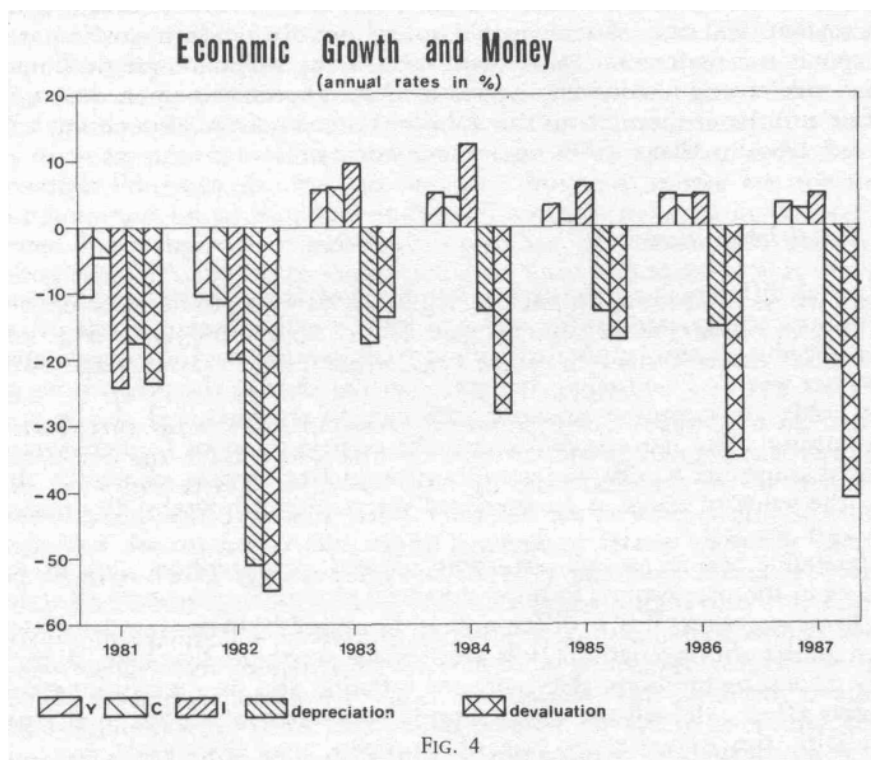
¹⁸ POHORILLE [1985].

¹⁹ TYLEC [1982]. See also OLES and SUMLINSKI [1987]

to emphasize here, despite many dissenting opinions, that repressed inflation also has significant redistributive effects, though the mechanism of redistribution differs in comparison with the hypothetical case of an open price inflation.

6. - Social Consequences of Inflation

Differences in living standards, amplified by inflation, directly entail negative social consequences. Systematic public opinion polls in countries where they are regular, including Poland, Yugoslavia and Hungary, are unanimous about that. In Poland, it is even clearly demonstrated that *differences in the economic status are the prime source of antagonisms between various social groups*. «Two criteria of social division are now predominant: economic status, i.e. wealth, salaries, wages, incomes and political status, i.e. power, position, political convictions, party membership. Some 76% to 61% of the sample pointed to the economic criterion (half of the respondents replied «yes» without hesitation) and they were much more determined in their replies than in the case of the political criterion. Half of the polled (58-49%) believed that political issues played no antagonizing role whatsoever»²⁰.



Source: Y (National Income), C (Consumption), I (Investment) - *Statistical Yearbook*, Central Statistical Office, Warsaw 1988, pp. 93-94. For 1988 - Central Annual Plan, Commission of Planning, Warsaw. Data for depreciation and devaluation - National Bank of Poland and own calculations.

Drawing on these observations (one must note that we are not discussing the pathologies of socialist economy here, but only some of its salient features during the reformation of the system and under shortageflation) one can put forward the thesis that *it is not the relation to the means of production, but that to consumer goods, which divides the society*. It is also in this area that lie the potential threats to economic, social and political stability.

²⁰ KWIATKOWSKI [1987].

Lastly, there is another phenomenon which must be noted against the background of inflation: I have earlier referred to it as the *paradox of lower fulfillment of the needs at higher overall consumption levels*²¹. Consumption is generally on the rise - though its growth rate has clearly dropped in the recent years in most socialist countries - but households feel they are worse and worse off. At high inflation levels there is a relatively greater proportion of households affected with an absolute drop in consumption financed with current incomes²². Interestingly enough, population groups whose real incomes had actually risen, also claim their living standards are declining. This is due to a widening gap between their expectations (with regard to consumption) and their fulfillment. While this gap persists, households will keep on claiming that they are worse and worse off and politicians - armed with statistical data - will vainly strive to convince them of the contrary. These contradicting views are also due to the fact that the population tends to evaluate living standards in terms of the currency's strength (i.e. money's ability to buy). Politicians tend to attach more importance to macroeconomic trends²³. These different views on the same real-life situation are depicted in Fig. 4. The national income (Y), consumption (C) and investment (I) have been on the rise since 1983, while money's purchasing power and exchange rate plummeted.

Observation of the public opinion in the recent years shows that the influence of this paradox is proportional to inflation rate. On the one hand, this is due to proportionally stronger redistributive effects and - on the other - to differences between the subjectively evaluated rising cost of living and its statistical, official index. The latter can tend to underestimate the real figure for consumer goods²⁴; this underestimation will tend to be more serious for higher inflation rates.

One shouldn't be therefore surprised by diminishing popular support for economic reforms. Many social and professional groups feel that inflation or - more precisely - its excessive rate, is due to the implementation of economic reforms. Actually, as it was demonstrated earlier, this popular sentiment is not unfounded. It is in this sense *that from an instrument which contributed to greater economic flexibility and facilitated the implementation of necessary adaptive processes and structural changes, inflation eventually became one of the major obstacles to the implementation of economic reforms*.

7. - Political Determinants and Relationships

Persisting and - sometimes - mounting economic problems, paralleled by serious social contradictions, eventually end up in increasingly serious political problems. This is also the case when economic reforms are accompanied by inflation. Public-opinion polls mentioned earlier supply ample evidence: «Dissatisfaction with living standards and overall economic situation is translated into attitudes towards the political system, into an appraisal of political rule and consolidates into political views. Political views are not solely related to the appraisal of political issues, but depend on economic and social issues, living standards, on how the population sees its future and prospects»²⁵. Obviously, inflation renders these problems more

²¹ Kolodko [1986].

²² Given the inflation rate in Poland in the five last years, it can be estimated that about half of the household had experienced a decline in the level of their real incomes, though statistics show a minimum 2% annual increase. Speaking of real income indices I refer to their statistical image, which - however - loses its sense in the conditions of such deep disequilibrium and shortage of consumer goods.

²³ Kolodko and Szablewski [1987].

²⁴ Adirim [1983] and Winiecki [1986].

²⁵ Kwiatkowski, *ibidem*.

acute. This is why solving them should rely, among other things, on the skilful containment of inflation, which may be a tough task, especially in the early stages of economic reforms.

The Soviet Union now is also facing the necessity to open its inflation. The introduction of market-type relations calls for objective pricing, capable of playing the role of exogenous economic parameters for economic organizations. Only prices which reflect social manufacturing costs and the dynamic demand/supply balance can play this role. Given that households have excess purchasing power, this implies that the overall price level must rise. Under the traditional, highly centralized system, such price operations did not always involve the «inflationary shock» or a cumulative price increase. In Bulgaria in 1980 for example, the overall price level rose by 14%, but the inflation spiral hadn't been triggered-off. Economies which were introducing market mechanisms suffered from all these symptoms. Thus, price inflation is unavoidable when reforming economic mechanisms, though a sound economic policy should contain its scale.

The more political tension there is, the more difficult it becomes to implement proper anti-inflationary policies, which are then more indispensable than at any other time. Polish experiences of the eighties are once again the most conclusive proof.

Employment has a political tinge, but it is an issue with meaningful economic implications and consequences. The proper operation of a controlled market without an effective labor market is hardly conceivable. Labor markets in socialism still suffer from inadequate development. This situation has definite pro-inflationary consequences, due to its impact on the chronic disequilibrium of the national economy, reflected in the demand which always outstrips supply. Socialist countries now face a political challenge: the choice between perpetuating «anti-efficient» full-employment policies (actually, this is partial over-employment, i.e. latent unemployment) or shifting to controlled unemployment. Many authors believe that the second choice is more effective²⁶ from the economic point of view, without being more expensive in terms of social cost, than the perpetuation of shortages in the consumer market, which result from «over-employment». The two phenomena are clearly correlated²⁷.

Inflation which accompanies economic reforms aggravates economic contradictions, but also the political ones. One must also bear in mind that unsuitable methods applied to solving these contradictions and timing errors can make them even more serious. It would appear that the dominant belief still is that necessary political reforms, reflected in far-reaching democratization of public life, should result from appropriate changes in the economy. Thus, this approach is biased with the conviction, that changes in the economic system still determine those in the political environment.

One may have certain doubts on that respect. It would appear that sometimes, it is actually the reverse which is true. *A further democratization of economic activities calls for democratization in social and political life. It is difficult to implement tight-budget and dear-money policies - which are a must, if economic reforms are to succeed - without appropriate institutional and systemic changes in political institutions. It is also difficult to anticipate more initiative on the part of the business sector, unless the powers of the political and economic centre are genuinely limited.* So far, no socialist country has made adequate progress in this area. It is hardly surprising, given that it is still assumed that the bureaucracy

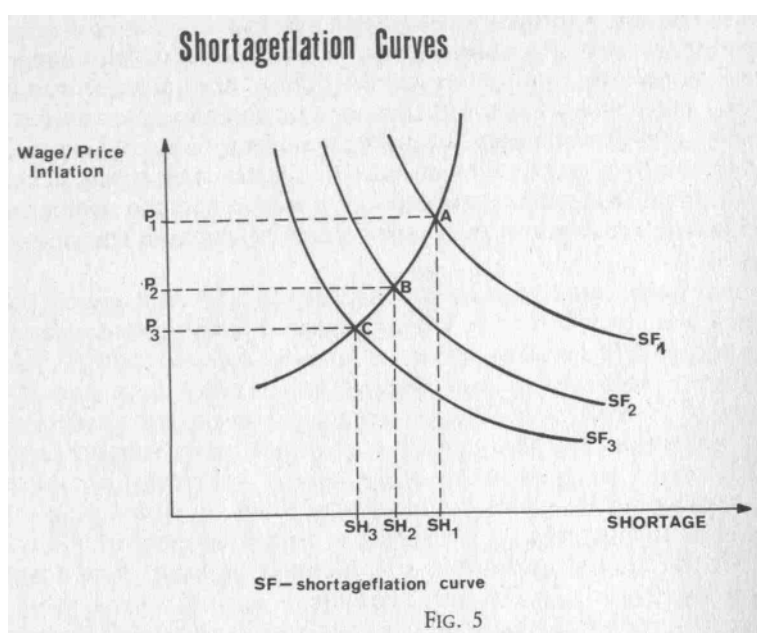
²⁶ SZMIELOW [1987].

²⁷ KOLODKO and McMAHON, op. cit.

and the central authorities will themselves limit their powers. And yet, such limitation is really indispensable if reforms are to work. Otherwise, the contradictions between various social and professional groups, social strata and classes, will be turned into a state vs. society relationship. *Struggles for a greater share of the national income, under the conditions of shortageflation, are a perfect example of this transformation of contradicting interests.*

8. - Inflation and Economic Reforms - Prospects

Some view inflation as a chance to accelerate reforms; others - as a major evil. I believe the latter are right. This is why efforts should be made to gradually contain shortageflation. As shown in Fig. 5, this should be done by simultaneously moving along the shortageflation curve to bridge the inflationary gap with price rises rather than with forced savings (i.e., to the left and up the shortageflation curve) and by shifting to curves positioned nearer the intersection of the X and Y axes, which implies preemptive bridging of the inflationary gap. This is possible, which is why all variants which assume another rise in the price inflation rate should be rejected as ineffective. *Economic policy can consider only those measures which favour both the reduction of the price inflation rate and lower shortages*²⁸. Naturally, these observations apply to reformed socialist economies, already strongly affected by shortageflation.



One must also emphasize here, that in many cases there is no need for sharp grant cut-offs and therefore - for stimulating inflation. This applies mostly to goods with a low price elasticity of the demand (e.g. public transport, central heating when no thermostats are available, etc.) and to goods whose consumption should be promoted (e.g. milk and some dairy products). One must remember that creating saving habits, e.g. with regard to hot water or use of public transport, requires appropriate technical facilities or the creation of real alternatives. If there are none, then, first - demand remains constant and there are no savings and second - given the share of these items in household budgets, their rising cost must be - in principle - fully compensated. Thus, the effect is pro-inflationary. Admittedly, public grants

²⁸ Given the economic structure and the balance of political and social forces in Poland, price increase triggers off such strong pressure on wage rise and the rise of other persona incomes, that the situation takes on a permanent character. See CHAREMZA and GRONICK [1985].

and subsidies are excessive, but we should nevertheless avoid the other extreme²⁹.

Experiences offered by reformatory activities in socialist economies so far are hardly inspiring. Stagnation trends recently observed in Hungary and Yugoslavia, unsolved structural problems, low competitiveness in foreign markets and resultant shortages of foreign exchange, plus a very high inflation rate are the sources of particular concern.

On the other hand, there is a genuine need for in-depth changes in the operation of socialist economies and of their community, i.e. the CMEA³⁰ as this is a prerequisite for the further civilization progress and for meeting impending growth challenges³¹. Ending on a warning note, one must add that balancing the market, introducing the capital market, the development of an effective labor market and achieving currency convertibility will only offer a chance to solve and not a solution to all economic and social problems.

²⁹ K.F. BOULDING [1982] had observed in this respect that «...the strengthening conviction about the inefficiency of public subsidizing constituted a serious threat to the society given its destructive impact on its morale, on its faith in its own forces, on the visions of future, and on the society's trust that it can manage its own matters ». See: BOULDING [1982], p. 3.

³⁰ CSABA [1986].

³¹ When asked, whether reforming the socialist economy could be pushed farther than done in Hungary, JANOS KORNAI [1986] admitted that he had ambiguous feelings: «The author must frankly confess his own ambivalence. As a Hungarian citizen he sincerely hopes that the answers to the series of questions raised above will be positive. As an occasional adviser, he may try to help the process go in the direction outlined. As a researcher he reserves the right to doubt». See: KORNAI [1986], p. 1734.

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