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Economic Reforms and Inflation in Socialism: Determinants, Mutual Relationships and Prospects

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One by one socialist countries are starting on the road of radical economic reforms. This transition has not so far been adequately studied or described in the 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 the surface or are intensified.

Inflation in its price form is one such 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 a market-like environment.

Determinants of and Barriers to 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 was observed long ago that the growth opportunities offered by the traditional centralised and bureaucratised management system were near exhaustion. These observations usually gave way to statements about the necessity of transition to a new growth stage, described as intensive growth. However, no centralised economy has achieved this stage so far and they are still dominated by the extensive approach to growth. In some of the countries one can observe stagnation, owing to the exhaustion of extensive growth factors.

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

There are at least three reasons to expand the scope of market-type relations and develop them further. First, the marketplace is a vital source of information about social needs[1]. After all, their optimal fulfilment is the professed goal of production under socialism. It is also obvious that it cannot be the production goal on the micro-economic scale. Actually, the main objective of economic reforms, apart from stimulating entrepreneurship, is to devise a mechanism capable of harmonising the goals at different levels of the economy. The lack of market information hinders the proper allocation of production factors - labour and capital - and entails all the inevitable structural consequences. Second, there is the objective necessity to strengthen the role of money and related categories, in order 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.

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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 govern 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 - economic and middle-level 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 subject to central planning.

Finding the right proportions between the market and the plan, as two parallel regulatory sub-systems of the national economy, will be 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 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 production and investment 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 limitation of their own 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 for the first two requirements, the situation varies in different countries. Social approval has declined in Yugoslavia, Poland and Hungary. The situation in China and the USSR differs. This is quite understandable, since the 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.

Releasing or Stimulating Inflation?

Releasing inflation could appear to be one of the preconditions of successful economic reforms. This approach assumed that, following certain adaptation processes, inflation would remain at moderate levels. This was expected to happen thanks to durable improvements in overall productivity and the elimination of the excess demand of the pre-reform era. Time has proved otherwise. Thus, the thesis that economic reforms only release inflation, replacing shortages with open price inflation, calls for verification[2]. It is important, because countries which have progressed with economic reforms have found lasting and high inflation unavoidable. We thus come to the question: can countries which initiate economic reforms now avoid the same fate? [3]

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

The lack of tight money[5] policies produces a situation where money plays a passive and secondary role in relation 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 has been estimated (annual rates) for the 1977-84 period for the CMEA countries as follows: [6]

- Bulgaria 6.9%.
- Czechoslovakia 5.1%.
- GDR 3.1%.
- Poland 29.4%.
- Romania 8.3%.
- Hungary 8.9%.
- Soviet Union 4.6%.

The scale and make-up of shortageflation differ from country to country, as their price inflation rates and the severity of shortages differ. It appears that shortageflation is a transition stage to a 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 recall that stagflation - inherent in contemporary capitalist economies for more than a decade - is a cost that these economies have been paying for structural adaptation, connected mainly to the two 'price shocks' of 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 and different economic conditions. This payment has been deferred for quite a time in some cases, but cannot be postponed for ever. 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 and repressed inflation in the implementation of economic reforms.[8] The point is that real-life social and economic mechanisms no longer permit inflation to be fully repressed but do not yet permit - mostly for political and social reasons - recourse to open price inflation. Given the financial and economic mechanisms implemented hitherto, especially with regard to investment, wage, income and credit policies, featuring the 'soft budget constraint', shortages are bound to persist, along with various survivals of the former management system - mostly various forms of rationing.

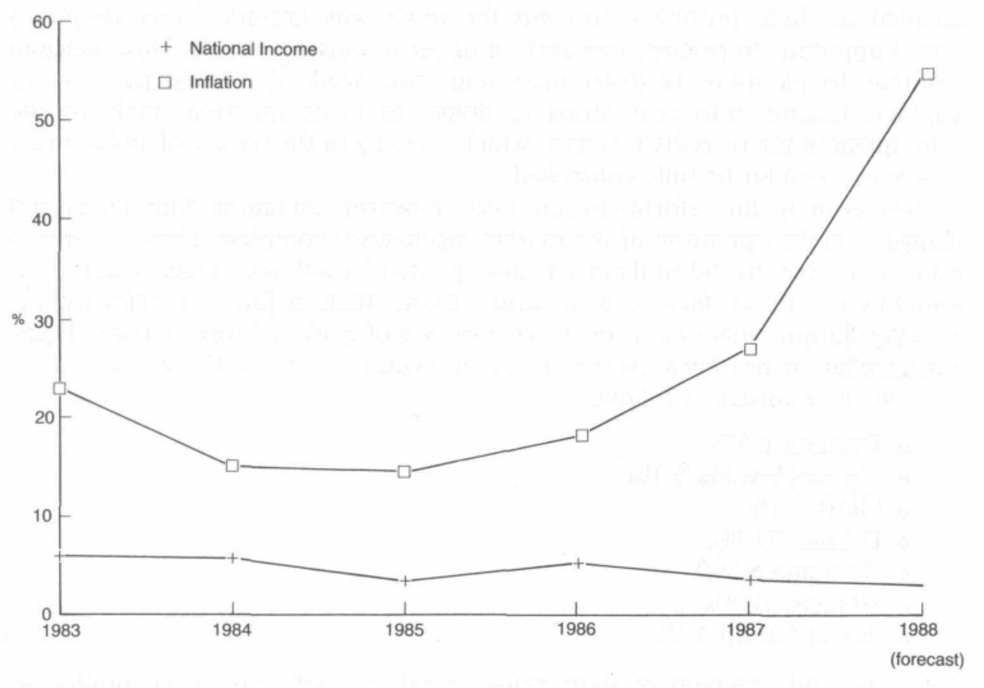

Figure 1. Economic growth and inflation - Poland.

There no doubt remains the short-term choice between various price inflation and shortage rates. Higher price growth equals lower shortages and viceversa. This view has not yet been recognised by some authors.[9] 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 created it in the first place remains.[10] In the long term, however, this alternative loses its importance, owing to the inflationary spiral in the reformed economy: persisting shortages are replicated at ever higher price (and income and cost) levels.

Drawing on Yugoslav, Polish and Hungarian historical experience, 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 overhaul of the operation of the economy. It is now recognised that this process has a life of its own and constitutes a threat to reform efforts. In other words, inflation has not become an instrument facilitating necessary adaptation processes; instead, it has turned into one of the fundamental barriers. This barrier is visible at all levels: economic, social and political.

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 form[11] - is one of the methods of achieving higher investment rates and financing additional investment.[12] Without getting involved in the details, one must say that excessive inflation rates observed in Poland and Hungary in recent years have contributed to a relative depression of economic growth (Figures 1 and 2). The same can be said about Yugoslavia (Figure 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 macro-economic inflation can be analysed, among other ways, in the light of micro-economic behaviour. 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 indeed.[13]

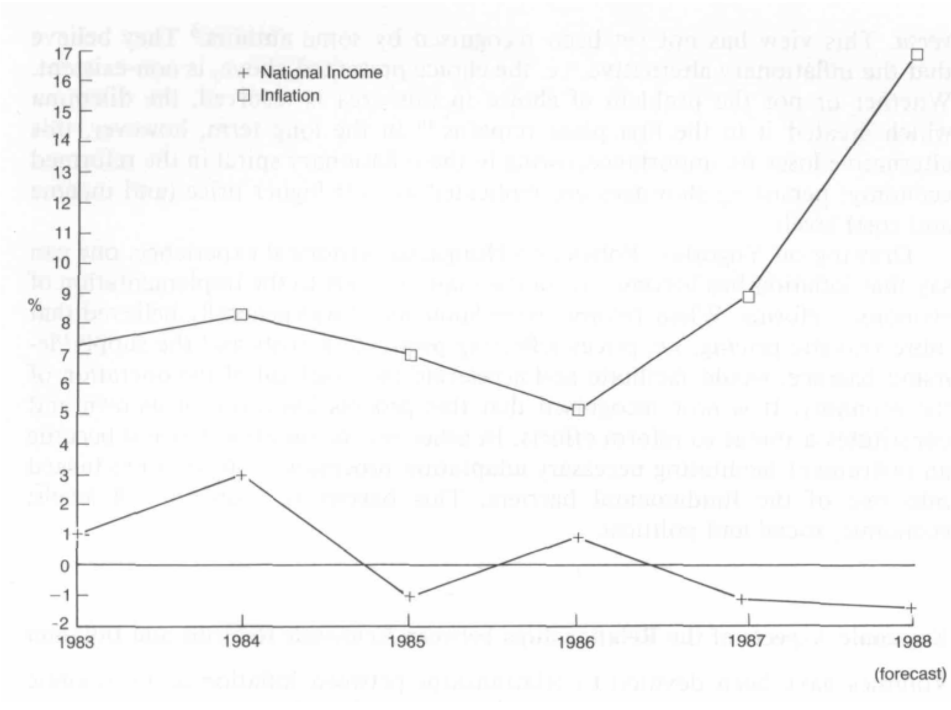

Figure 2. Economic growth and inflation - Hungary.

Even when there are no administrative price controls and no social or political opposition to price increases, companies do not raise prices 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 upward steps in the prices of production factors. Companies operating on the cost-plus-margin principle then increase prices for their products, compensating for increased costs and remaining at the same level of profitability. If they had moved nearer to equilibrium prices earlier, defending the current profitability level would then have called for improved efficiency, mostly through cost reductions or increased output.

When excess demand is perpetually increased by the inflationary spiral, producers are unlikely to encounter sales problems. On the macro-economic scale, expenses equal receipts. If there is no saving, 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 raising their prices.

If this is the process that we are really facing, then economic policy should stimulate producers to raise 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 now be observed in our social and economic environment however, are measures aimed in the opposite direction. They are prompted by anti-inflationary sentiments but generate inflationary effects and, most of all, they contribute to the persistence of the mechanism of demand-pull inflation.

These strategies pursued by firms result in macro-economic shortages, which cannot be accurately estimated. There is enough evidence, however, to demonstrate that the inflation and national income growth rates are meaningful figures in this context, in the Polish economy at least. Without concerning ourselves here with the utility of the concept of the inflationary overhang for analysing the market situation,[14] we can say that between 1982 and 1987 this overhang was equal to 15-30% of the Polish population's purchasing power.[15] 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 growth or quantum leaps in supply.

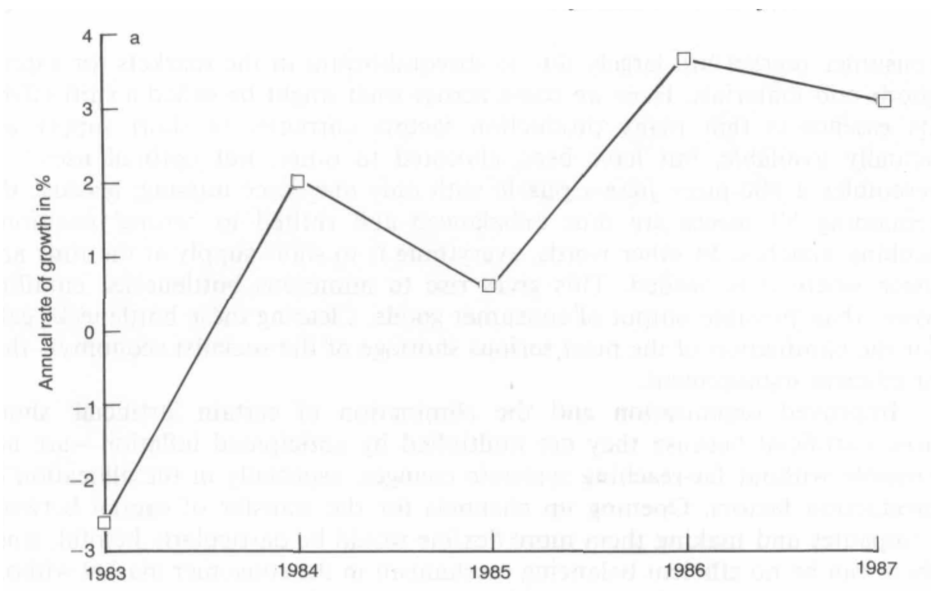

Figure 3(a). National income - Yugoslavia.

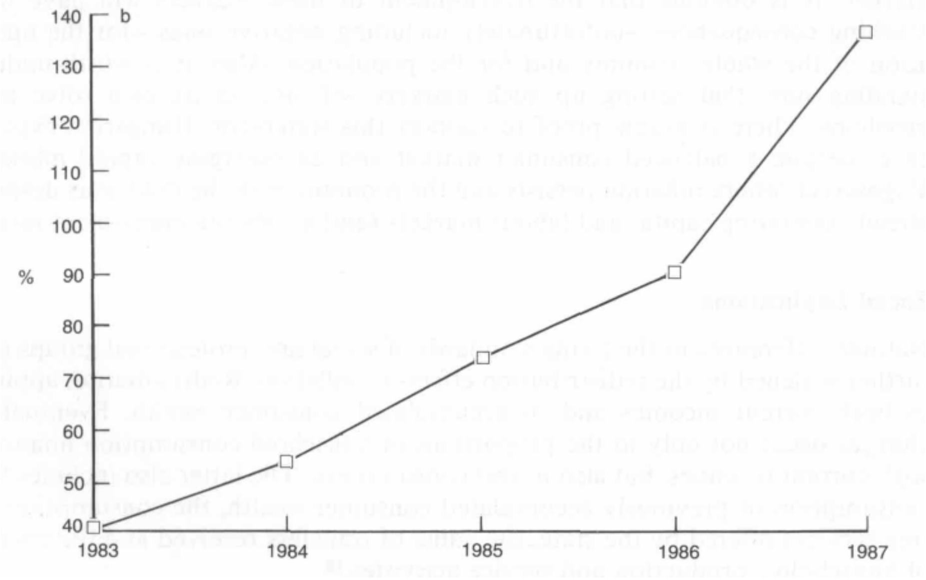

Figure 3(b). Annual rate of inflation - Yugoslavia.

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 behavioural patterns. Lowering the population's estimates of future inflation could increase the propensity to save and thus reduce demand.[16] 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 raises the population’s expectations of future price rises and contributes to the persistance of this unsatisfactory situation.

Reversing these negative trends, however, would require certain definite stimuli on the supply side. It is worth noting here that shortages in the consumer market are largely due to disequilibrium in the markets for 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, but have been allocated to other, not optimal uses.[17] It resembles a 100 - piece jigsaw puzzle with only one piece missing; because the remaining 99 pieces are thus unbalanced and shifted to 'wrong' 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 organisation 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 up channels for the transfer of capital between 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. This will remain impossible unless the marketisation of economic relations is pushed farther still, to include the creation of a labour market. It is obvious that the development of these markets will have far-reaching consequences - unfortunately including negative ones - for the operation of the whole economy and for the population. Also, it is worth understanding now that setting up such markets will not on its own solve any problems. There is ample proof to support this statement: Hungarian experience, despite a balanced consumer market and an emerging capital market; Yugoslavia, where inflation persists and the economy is in the doldrums despite already operating capital and labour markets (and a 14% unemployment rate).

Social Implications

Natural differences in the living standards of social and professional groups are further widened by the redistribution effects of inflation. Redistribution applies to both current incomes and to accumulated consumer wealth. Eventually, changes occur not only in the proportions of household consumption financed with current revenues, but also in real consumption. The latter also includes the consumption of previously accumulated consumer wealth, the consumption of free services offered by the state, the value of transfers received and the results of households' production and service activities.[18]

Regrettably, there are no estimates of real consumption, or of the changes in the shares of it enjoyed by different social groups. Fragmentary information, however, shows[19] that differences in households' living standards also widen under shortageflation. It is worth emphasising 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 open price inflation.

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 has even been clearly demonstrated that differences in 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 - power, position, political convictions, party membership. Some 61-76% 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 those polled (49-58%) believed that political issues played no antagonising role whatsoever.[20]

Drawing on these observations (it should be noted that we are not discussing the pathologies of the socialist economy here, but only some of its salient features during the reform 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 society. This is also the area in which the potential threats to economic, social and political stability lie.

Lastly, there is another phenomenon which must be noted against the background of inflation: I have elsewhere referred to it as the paradox of lower fulfilment of needs at higher overall consumption levels.[21] Consumption is generally on the rise - although its growth rate has clearly dropped in recent years in most socialist countries - but households feel they are worse and worse off. At high inflation levels a relatively greater proportion of households experiences an absolute drop in consumption financed with current incomes.[22] Interestingly enough, population groups whose real incomes have actually risen also claim that their living standards are declining. This is due to a widening gap between their expectations (with regard to consumption) and fulfilment. While this gap persists, households will keep on claiming that they are worse and worse off and politicians - armed with statistical data - will strive in vain 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 macro-economic trends.[23] These different views on the same real-life situation are depicted in Figure 4. The national income, consumption and investment have been on the rise since 1983, while the purchasing power of money and the exchange rates have plummetted.

Observations of public opinion in recent years show that the influence of this paradox is proportional to the 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 the official statistical index. The latter can tend to underestimate the real figure for consumer goods,[24] and this underestimation will tend to be more serious for higher inflation rates.

One should not be surprised, therefore, by diminishing popular support for economic reforms. Many social and professional groups feel that inflation or, more precisely, the excessive rate of inflation, is due to the implementation of economic reforms. This popular sentiment is not unfounded, as we have seen. It is in this sense that inflation, from being an instrument which contributed to greater economic flexibility and facilitated the implementation of necessary adaptation processes and structural changes, eventually became one of the major obstacles to the implementation of economic reforms.

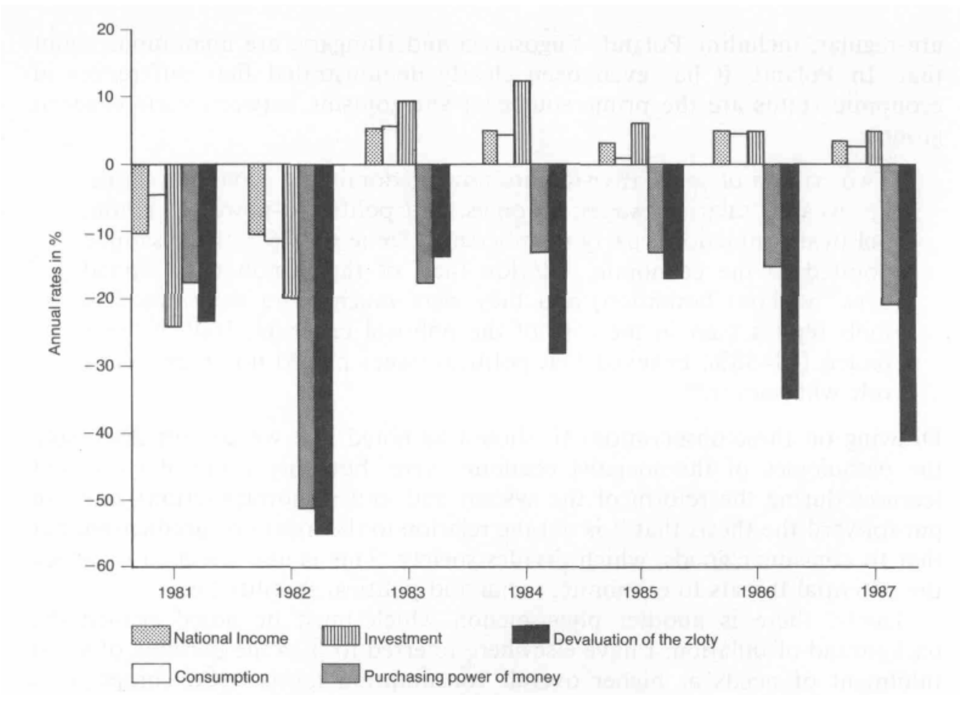

Figure 4. Economic growth and money.

Political Determinants and Relationships

Persisting and sometimes mounting economic problems, paralleled by serious social contradictions, eventually become increasingly serious political problems. This is also the case when economic reforms are accompanied by inflation. Public opinion polls supply ample evidence:

> Dissatisfaction with living standards and the overall economic situation is translated into attitudes towards the political system, into an appraisal of political rule and consolidated 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 acute. This is why solving them requires, among other things, 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 release inflation. The introduction of market-type relations calls for objective pricing, capable of playing the role of exogenous economic parameters for economic organisations. 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 be raised. Under the traditional, highly centralised system, such price operations did not always involve an 'inflationary shock' or entail cumulative price growth. In Bulgaria in 1980, for example, the overall price level rose by 14%, but the inflation spiral was not triggered. 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 experience of the 1980s is 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 labour market is hardly conceivable. Labour markets under socialism still suffer from inadequate development. This situation has definite pro-inflationary consequences, owing to its impact on the chronic disequilibrium of the economy, with demand always outstripping 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 effective[26] from the economic point of view, without being more expensive in terms of social cost, than the perpetuation of the shortages in the consumer market which result from 'over-employment'. The two phenomena are clearly correlated.[27]

Inflation accompanying economic reforms aggravates not only economic but also political contradictions. One must also bear in mind that unsuitable methods applied to solving these contradictions, and errors of timing, can make them even more serious. It would appear that the dominant belief still is that necessary political reforms, reflected in far-reaching democratisation of public life, should result from appropriate changes in the economy. Thus, this aproach is biased with the conviction that changes in the economic system still determine those in the political environment.

One may have certain doubts in that respect. It would appear that, sometimes, it is actually the reverse which is true. Further democratisation of economic activities calls for democratisation 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. This is hardly surprising, given that it is still assumed that the bureaucracy 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.

Inflation and Economic Reforms - Prospects

Some view inflation as a chance to accelerate reforms; others see it as a major evil. I believe the latter are right. This is why efforts should be made gradually to contain shortageflation. As shown in Figure 5, this should be done by simultaneously moving along the shortageflation curve to bridge the inflationary gap with price increases rather than with forced saving (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 pre-emptive 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. Naturally, these observations apply to reformed socialist economies already strongly affected by shortageflation.

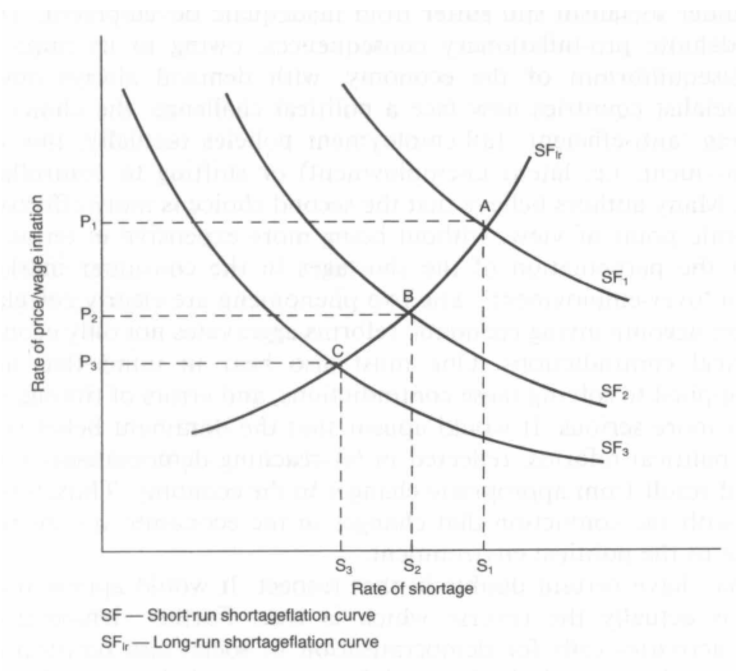

Figure 5. The shortageflation curves (dynamic presentation).

We should therefore avoid the peculiar 'anti-subsidy euphoria', which tends to be adopted as the spearhead of price and income policies in the 'second stage' of economic reforms. Interestingly enough, the same arguments used prior to the 1982 price reform are repeated now. However, despite a tenfold increase in prices over the past six years (1981-88) price proportions are no better, while the structure of incomes is even worse than before 1982. Another major increase in the price level would be very hard to implement now, owing to social and political considerations and, moreover, it is not an economic necessity. The success of economic reforms depends not so much on eliminating subsidies as on balancing the economy and this should be the goal of price and income policies, and of all auxiliary economic and financial instruments.

Equilibrium is more easily achieved by containing price and wage inflation than by stimulating both.[28] This, of course, calls for an appropriate decline in the rate of growth of all economic organisations' revenue and, furthermore, for an adaptation of the money supply growth rate to that of the real national income. It is therefore a most amazing view that an inflation rate slightly in excess of 10% (and more or less corresponding wage growth) is equivalent to price pegging and freezing wages. It is at such high inflation rates that capitalist countries implemented major structural changes.[29] Why then should it be impossible in reformed planned economies?

Actually, far-reaching changes in relative prices and a curtailment of counter-productive subsidies can be achieved with a simultaneous decline in the inflation rate and less severe shortages.[30] Such are the proposals of the Consultative Economic Council[31] and those contained in the Currency Stabilisation Programme of the Central Bank.[32] This calls for brand new, tighter monetary and fiscal policies. These policies, however, are still dependent, to a large extent, on political considerations. This is why these problems cannot be solved on the economic plane only. 'What determines whether or not a management system can be implemented is not its economic attractiveness or theoretical rationality, but the existence of forces genuinely interested in its implementation'.[33] There is also no doubt that the configuration of these forces is dependent on the nature and intensity of inflationary processes.

One must also emphasise here that in many cases there is no need for sharp subsidy cuts and the consequent stimulation of inflation. This applies mostly to goods with a low price elasticity of 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 these do not exist, then, first, demand remains constant and there are no savings and, second, given the weight of these items in household budgets, their rising cost must be, in principle, fully compensated. Thus, the effect is inflationary. Admittedly, such subsidies are excessive, but we should nevertheless avoid the other extreme.[34]

The experience offered by reform in socialist economies so far is 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, the CMEA,[35] as this is a prerequisite for the further progress of civilisation and for meeting impending growth challenges.[36] Ending on a warning note, one must add that balancing the market, introducing a capital market, developing an effective labour market and achieving currency convertibility will offer only a chance to solve, not a solution to all economic and social problems.

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13. I refer here to the 'free' prices which can, in principle, be agreed between producers and buyers, though they are often subject to various limitations. According to the principles of economic reforms, these prices should be set on the basis of demand/ supply balance, i.e. they should be equilibrium prices.
14. A. Topinski, 'Gdzie ten nawis?' (Where is that gap?), *Zycie gospodarcze*, 30, 1986.
15. For more on this see, among others, G. W. Kolodko, *Polska w swiecie inflacji* (Poland in the World of Inflation), (Warsaw, KiW, 1986); *Gospodarka w procesie reformowania* (Economy in the process of reforms), J. Pajestka, ed. (Warsaw, PWE, 1986); M. Gorski & G. Jedrzejczak, *Rownowaga i stabilnosc w gospodarce socjalistycznej* (Equilibrium and stability in the socialist economy), (Warsaw, PWN, 1987).
16. M. Oles, 'Wplyw procesow inflacyjnych na poziom i strukture zasobow pienieznych

ludnosci' (The impact of inflationary processes on the level and structure of the population's financial wealth), *Studia Finansowe*, 32, 1985.

17. This is most visible with regard to labour, where the deficits persist, though there actually should be a surplus.
18. M. Pohorille, *Potrzeby, podzial, konsumpcja* (Needs, distribution, consumption) (Warsaw, PWE, 1985).
19. B. Tylec, 'Konsumpcja realna gospodarstw domowych' (Households' real consumption), in: *Tendencje rozwoju konsumpcji. Postulaty i uwarunkowania* (Consumption patterns. Postulates and determinants), Maksymilian Pohorille, ed. (Warsaw, PWE, 1982); M. Oles & M. Sumlinski, 'Oszczgdnosci a rozmiary i struktura majatku gospodarstw domowych' (Savings vs. the level and structure of households' wealth), (Warsaw, Instytut Finansow, 1987) (mimeographed typescript).
20. S. Kwiatkowski, 'Co Polakow dzieli?' (What divides the Poles?), *Polityka*, 28, 1987.
21. Kolodko, *op. cit.*, Ref. 1.
22. Given the inflation rate in Poland in the last five years, it can be estimated that about half of all households 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 the statistical picture, which, however, loses its meaning in conditions of such deep disequilibrium.
23. G. W. Kolodko & A. Szablewski, 'Pieniadz – gospodarka - spoleczenstwo' (Money – economy - society), *Wektory*, 5-6, 1987.
24. I. Adirim, *Stagflation in the USSR* (Falls Church, VA, Delphic, 1983); J. Winiecki, *Zrodla inflacji w gospodarce rynkowej i w gospodarce planowej* (Inflation sources in market and centrally-planned economies), (Warsaw, PWN, 1986).
25. Kwiatkowski, *op. cit.*, Ref. 20.
26. N. Shmelev, 'Avansy i dolgi' (Merits and Drawbacks), *Novyi mir*, 6, 1987.
27. Kolodko & McMahon, *op. cit.*, Ref. 6.
28. Given the economic structure and the balance of political and social forces in Poland, price growth triggers such strong pressure on wage growth and the growth of other incomes that the situation takes on a permanent character. M. Charemza & M. Gronicki, *Ekonometryczny model nierownowagi gospodarczej Polski* (Econometric model of Poland's economic disequilibrium), (Warsaw, PWE, 1985).
29. In Switzerland and in the FRG, for example, the inflation rate never exceeded 7% in the past 35 years. Even now, two - digit inflation is a rarity among advanced capitalist countries.
30. G. W. Kolodko, 'Na jaka inflacje jestesmy skazani?' ('What rate of inflation are we doomed to?'), *Zycie Gospodarcze*, 33, 1985. K. Lutostanski, in his paper 'Jakie tempo zakladac?' (What rate to assume?), *Zycie Gospondarcze*, 38, 1985, and M. Mieszczankowski in 'O inflacji' (About inflation), *Zycie Gospodarcze*, 49, 1985, present a different view. These authors suggest that inflation has mostly a cost-push nature and this alone is enough to make it high. Now, one should remember that in an economy comparable to Poland or Hungary, wage growth is responsible for some 80% of inflation. *Vide* T. Erdos, 'Causes of inflation and the outline of stabilization policy for Hungary', paper presented at the conference on 'Balancing Problems in Economic Reforms' (INE, PAN, Warsaw, 19-21 May 1987) (mimeographed typescript).
31. 'Droga do rownowagi' (The road to equilibrium), part 2, *Zycie Gospodarcze*, 43, 1986.
32. *Program umacniania pieniadza* (Currency Stabilization Program), Narodowy Bank

Polski (Warsaw, May 1987).

33. *Gorski and Jedrzejczak*, op. cit., Ref. 15, p. 43.
34. K. F. Boulding had observed in this respect that the strengthening conviction about the inefficiency of public subsidising constituted a serious threat to society, given its destructive impact on its morale, on its faith in its own forces, on visions of the future and on the society's trust that it could manage its own affairs. K. F. Boulding, 'Pathologies of the Public Grants Economy', in *The Grants Economy and Collective Consumption* (London, Macmillan, 1982).
35. L. Csaba, 'CMEA countries and East-West trade', *Comparative Economic Studies*, XXVIII, 3, 1986.
36. When asked whether reforming the socialist economy could be pushed farther than had been done in Hungary, Janos Kornai 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'. J. Kornai, 'The Hungarian reform process: visions, hopes and reality', *Journal of Economic Literature*, XXIV, 4, 1986.