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Stabilization, Recession And Growth In A Postsocialist Economy

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1. Causes and Scale of Recession in a Post-Socialist Economy

The post-socialist economy is one in which an irreversible process of transformation from a planned allocation system to a market one is taking place alongside the development of a democratic, pluralistic society. This process has already spread over more than twenty states, including those of the former Soviet Union. The remarks and conclusions which will be formulated here regard those countries as a whole, in principle, although in many cases empirical data sufficiently reliable to make general judgements are not yet available. What is more, the process in question is still *in statu nascendi* and, therefore, far-reaching generalizations would be fraught with the risk of going beyond the limits of professionalism, since the experience of transformation in the post-Soviet Asian republics is quite different from that of Poland and Hungary.

To mention just two of the main differences - the Asian republics are at the very beginning of the market-oriented transformation process, starting from a traditional Soviet economy, largely disintegrated and entangled in widespread political, institutional and structural upheaval. In Hungary and Poland, the transformation process is already at an advanced stage and the starting point, too, differed considerably owing to previous market-oriented reform of the socialist economy in those countries. However we assess those reforms, there is no doubt that they are facilitating the market-oriented transformation process [Nuti D.M., 1992]. Despite these and many other differences [Bozyk P., 1992] it is nevertheless worth trying to answer the question about the general conditions, interrelations and prospects of stabilization and economic growth m the post-socialist economy.

While, from the spatial point of view, the notional scope for the post-socialist economy has widened in the course of the last few years', from the historical point of view this notion can, though not in every case, be referred to the Period beginning with 1990[2]. Thus, when referring to a post-socialist economy, reference is made to that period in particular and the European post-socialist countries in the first instance.

Before posing questions about the present day, a look at some indicators illustrating the dynamics of past development processes in the planned economies would be opportune. This is especially necessary, because at present we are often susceptible to a form of amnesia - forgetting the fact that over most of the period of so-called real socialism, the dynamics of the national product was by current international standards, rather high. The present views on those dynamics[3] are, on the one hand, formed under the impression of the low rate of economic growth during the declining phase of real socialism, and, on the other, deliberately formulated for political and ideological reasons, since the belittling and negation of past economic growth puts the contemporary processes and their political assessment in a different context.

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One of the characteristics of the economic growth process in the centrally planned economy was its cyclic character understood as endogenous oscillations of the growth rate around a long-term ascending trend [Kolodko G.W., 1975 and 1986]. Thus, as illustrated in Table 1, periods of higher and lower dynamics followed each other alternately.

The distinct weakening of development dynamics in the late 1980s was an undisputed fact. What is more, it was accompanied by increasing destabilization which found its expression, among other things, in the acceleration of inflationary processes, growing shortages and deepening external disequilibria. That a negative feedback between these processes took place is understandable, the results of which are still felt today. The weakening economic dynamics strengthened the destabilization trends, and the growing destabilization, in turn, bolstered the trend towards growth slow-down and, finally, contributed to stagnation [Kolodko G.W., 1989]. However, we still may not speak of decline in the output of those countries (see Table 2).

Except for Rumania and, to a lesser extent, Hungary, the aggregate product did not begin to fall until 1990[4]. A clear collapse was visible in that and the following two years, in parallel with a simultaneous decline in growth dynamics in the developed market economies (see Table 3).

The fact is that the recession only appeared when the phase of systemic transformation was entered. This might lead us to the conclusion that the decline in economic activity is directly connected with systemic transformation. Is this really so, however, and to what extent is the fall in output in the post-socialist economy a function of the transformation and its three components i.e. macroeconomic stabilization, institutional changes and microeconomic restructuring of production capacities? To what degree can this fall be explained by other factors? It is only on the basis of correct answers to the above two questions that solutions may be sought which will make it possible to find the road to growth.

Before doing so, however, a further question is worth posing - can the course of the actual processes in the post-socialist economy of the early 1990s be defined as recession? There are authors who deny the aptness of this definition to describe the phenomena in which we are presently entangled in Central and Eastern Europe, while stressing their specific, or even unique character. With this approach the notion of recession is, in principle, exclusively reserved for a specific phase of the business activity cycle typical of a market economy. The post-socialist economy, by its very nature and definition, is not a market economy. It is also no longer a planned economy [Kolodko G.W., 1990a]. Hence, by recession we understand a phase of reduced economic activity during which the absolute level of GDP declines. Depending on whether we are talking about the classical or modified (modern) business cycle, that phase follows the boom (prosperity) or the recovery, respectively. In turn, it precedes the depression phase in the classical cycle or the recovery phase in a modern cycle. In this perspective, the emphasis is laid on the regularity of the process, though recently it is far removed from the regularity typical, for example, of natural or astronomical cycles.

Table 1 - ECONOMIC GROWTH CYCLES IN SOCIALIST COUNTRIES (average yearly national product growth rates)

	Periods Growth rate (%)									
Bulgaria	...	1953-56	1957-59	1960-63	1964-67	1968-71	1972-75	1976-80	1981-85	1986-88
		6.5	14.0	6.0	9.1	7.4	8.3	6.4	3.5	5.2
		-	+	-	+	-	+	-	-	+
Czechoslovakia	1950-52	1953-56	1957-61	1962-65	1966-69	1970-75	1976-78	1979-84	1985-88	
	10.0	6.5	7.4	0.8	7.2	5.3	4.7	1.8	2.4	
		-	+	-	+	-	-	-	+	
GDR	1950-52	1953-56	1957-59	1960-63	1964-69	1970-75	1976-86	1987-88		
	18.0	6.7	8.7	2.2	5.0	5.7	4.4	3.3		
		-	+	-	+	+	-	-		
Hungary	1951-53	1954-56	1957-60	1961-65	1966-69	1970-74	1975-78	1979-85	1986-88	
	9.3	2.0	11.0	5.4	7.2	6.2	5.0	0.9	1.6	
		-	+	-	+	-	-	-	+	
Poland	1950-53	1954-57	1958-63	1964-68	1969-70	1971-75	1976-78	1979-82	1983-85	1986-88
	9.8	9.1	5.4	7.1	3.7	9.8	4.9	-6.5	4.9	3.9
		-	-	+	-	+	-	-	+	-
Romania	1951-53	1954-56	1957-59	1960-62	1963-66	1967-70	1971-76	1977-79	1980-84	1985-88
	17.0	5.0	10.6	7.6	10.5	7.0	11.5	7.7	4.0	5.4
		-	+	-	+	-	+	-	-	+
USSR	1950-51	1952-53	1954-56	1957-63	1964-68	1969-73	1974-78	1979-88		
	16.0	8.2	11.6	6.0	8.2	6.5	5.0	3.3		
		-	+	-	+	-	-	-		

... data not available

+ acceleration

- slow-down

Source: GUS, Rocznik Statystyczny (Statistical Yearbook), Warszawa, different years, author's own calculations.

Table 2 - BASIC MACROECONOMIC INDICATORS FOR EUROPEAN SOCIALIST COUNTRIES

		Net national product	Inflation(CPI) (%)	Current account balance (growth rate) (in % of NNP)
Bulgaria	1970-1979	7.1	0.7	…
	1980-1989	4.0	3.3	…
	1984-1989	3.8	2.8	-2.7[¦]
Czechoslovakia	1970-1979	5.0	0.9	-0.2
	1980-1989	2.0	1.6	0.2
	1984-1989	2.5	0.9	0.2
Yugoslavia[#]	1970-1979	6.1	17.5	-2.0
	1980-1989	0.7	74.9	-0.1"
	1984-1989	0.6	106.3	1.5[&]
Poland	1970-1979	6.7	4.1	…
	1980-1989	0.3	53.1	-3.6
	1984-1989	4.1	62.9	-1.4
Romania	1970-1979	9.7	0.8	-2.9[^]
	1980-1989	4.5	3.8	0.7[*]
	1984-1989	5.8	0.2	3.1[~]
Hungary	1970-1979	5.1	3.9	-4.4
	1980-1989	1.2	8.1	-2.2
	1984-1989	1.3	9.0	-2.0

[^] 1977-1979 percentage of gross national product (GNP) instead of.net national product (NNP)
[*] 1980-1986 percentage of GNP instead of NNP
[~] 1984-1986 percentage of GNP instead of NNP
[#] gross real product instead of GNP
" 1980-1986
[&] 1984-1986
[¦] 1985-1988
… reliable data not available
Source: national statistical yearbooks, different years, author’s own calculations.

The mechanism of transition from one phase to another is more important than its relative regularity. Thus, in the business activity cycle[5] this mechanism has an unambiguously endogenous character. The recovery phase creates the conditions for the future overheating of the economy and has inherent in it a relative or absolute decline in output level. Inversely, the recession phase creates the conditions for the transition to the recovery phase which, in the classical cycle, was preceded by a depressionary phase. In the case of a post-socialist economy, neither this character nor this sequence are really applicable, although a comparison with the classical cycle is to a certain extent inevitable. The main point to bear in mind is that in a post-socialist economy there is no automatic mechanism by which the phase of low economic activity may be overcome, while such a mechanism is inherent in the business cycle typical of a market economy. In this perspective, we really should not talk about recession, but give the process a different name. However, the problem does not consist in devising new definitions but in properly interpreting the developments in which we are enmeshed. So, let us accept that we are dealing with a recession, but one whose nature is different from that of classical recession as a phase of the business cycle in a capitalist market economy.

The recession typical of a post-socialist economy is characterized by the following features:

- firstly, it follows the phase of low economic activity (tending to stagnation) typical of the cyclic character of growth in the socialist economy;
- secondly, it manifests itself, among other things, in an absolute decline in output and investment levels (though not necessarily in other macroeconomic aggregates, such as exports);
- thirdly, in this case, the mechanism of automatic transition to the post-recession recovery phase does not work;
- fourthly, the sequencing of phases which follow the recession is not predetermined. Sometimes it is a sequence quite similar to that of the modern business cycle in a developed capitalist economy, which means that immediately after the decline in output the economy enters the recovery phase. More frequently -and clear signs of this are visible in a number of post-socialist countries- the recession will be followed by depression which, after passage through recovery, will lead to prosperity. It is only then that growth will follow and that its course will be more or less like that of a modern business cycle in capitalism.

In reality, events in some Central and Eastern European countries, namely Bulgaria, Czechoslovakia and Poland, appear to be following this very course. In these countries, the very low production activity has already persisted long enough for us to speak of the appearance of the post-recessionary depression phase, characterized both by the lack of any clear tendency towards a further decline in output and the absence of signs of growth trends. In other words, there is stagnation at a very low level accompanied by further growth in unemployment. This has already become a specific feature of depression in post-socialist economy distinguishing this phenomenon from its classical course [Kolodko G.W. and M. Rutkowski, 1991]. Trends in this field are shown in Table 4.

However, the sequencing and intensity of particular phases will ultimately be determined by the economic policy pursued in individual countries, especially by the systemic transformation policy in all its three components. In this field, the fundamental importance of both macro and microeconomic policies of the State is to be stressed, since the recession appearing in the post-socialist economy cannot be overcome without the State's active interference in the process. This is witnessed, among other things, by the experience of the 1990-1992 period.

Table 3 - DYNAMICS OF NATIONAL PRODUCT (NP) AND GROSS DOMESTIC PRODUCT (GDP) IN CHOSEN COUNTRIES, 1981-1992 (Rate of change, %)

		Yearly average			Preceding year = 100			
		1981-1985	1986-1988	1989-1991	1989	1990	1991	Forecast 1992
Poland	NP	-0.8	3.8	7.86^	-0.2	-14.9	-	-
	GDP	-0.2	3.4	6.6-7.2	0.2	-11.6	-8-10	-5-0
Bulgaria	NP	3.7	4.2	-11.0	-0.4	-11.5	-22.9	-
	GDP	-	-	-	-	-	-22.0	-
CSFR	NP	1.7	2.3	-5.0	1.3	-3.5	-	-
	GDP	-	-	-	-	-0.4	-15.9	-3-9
Romania	NP	4.4	5.1	-11.0	-5.8	-11.0	-	-
	GDP	-	-	-	-7.9	-15.0	-14.0#	0.0
Hungary	NP	-	-	-	-	-	-	-
	GDP	1.7	1.8	-4.5	-2.0	-3.3	-8.0	0-1
USSR*	NP	3.2	2.8	-5.7	2.4	-4.0	-15.0	-
	GDP	-	-	-	-	-	-17.0	-
Yugoslavia	NP	0.4	0.2	-10.4	1.0	-11.0	-20.0	-
	GDP	-	-	-	-	-	-	-
USA	GDP	3.0	3.6	1.0	2.5	1.0	-0.5	2.2
Japan	GDP	3.9	4.2	4.9	4.7	5.6	4.5	2.4
FRG~	GDP	1.2	2.6	3.8	3.8	4.5	3.2	1.8
France	GDP	1.5	2.7	2.7	3.9	2.8	1.4	2.1
Italy	GDP	1.5	4.0	2.0	3.0	2.0	1.0	2.0
UK	GDP	1.9	4.2	0.4	2.3	0.8	-1.9	2.2
Spain	GDP	1.4	4.6	3.6	4.8	3.7	2.5	2.9
Portugal	GDP	0.8	4.2	4.0	5.4	4.2	2.7	2.6
Finland	GDP	2.8	3.8	0.1	5.4	0.4	-6.2	-0.4
OECD	GDP	2.3	3.5	2.3	3.4	2.6	ca-1.0	ca-2.0
EEC	GDP	1.4	3.1	2.5	3.5	2.9	1.3	2.1

^ 2 years 1989-1990
* data for Community of Independent States (CIS)
~ without former GDR
# according to recent information, GDP has fallen by 5.8% which seems improbable in the light of other indicators
Source: Sytuacja, 1992.

Table 4 - UNEMPLOYMENT IN CENTRAL AND EASTERN EUROPEAN COUNTRIES, 1990-1991

	1990				1991			
	Thousands of persons	% Labour force	l half-year		III quarter		Year	
			Thousands	%	Thousands	%	Thousands	%
Poland	1,126	6.1	1,574	8.4	1,997	10.4	2156	11.4
Bulgaria	77	2.0	233	6.0	343	-	420	7.8
CSFR	77	1.0	301	3.8	446	5.6	524	6.4^
FormerGDR	-	-	1,060*	12.1*	1,030	11.7	1,040	11.8
Romania	-	1.5	260*	2.2*	261	3.3	400-500	4-5
Hungary	79.5	ca 2.0	186	3.9	298	6.6	406	ca 8
CIS	-	-	-	-	ca 1000	1.5	ca 1000	1.5
Yugoslavia	1,300	17.0	1,500	19.4	1,540	20.1	1,500	20.1

^ end of November 1991
* August 1991
~ September
Source: *Sytuacja*, 1992.

Recession in post-socialist countries is a fact, its scale is so spectacular that there is often talk about the collapse of the economy. The fall in output has been so large that according to the World Bank's most optimistic forecasts, output will not return to its pre-collapse levels before 1996 in the so-called northern part of the region (Czechoslovakia, Hungary, Poland) and before the year 2000 in the so-called southern part (Bulgaria, Rumania and Yugoslavia) [World Bank, 1991]. On the other hand, there are opinions which deny both the magnitude of the recession itself and its importance.

It should be noticed that assessments of this type are put forward the more intensive and persistent the recession proves to be, and the more difficult it is to overcome. Initially, the adequacy of official statistical data reflecting the scale of decline in industrial output which determined the national product level was questioned, suggesting the "sold output" category was inadequate [Rostowski J., 1990]. Later the compensating effect of the second economy on the global production level was accentuated. Initially, and -to be more precise- when an early appearance of positive trends in the real sphere was still expected, the small significance of the parallel sector (not registered by official statistics) was stressed. The International Monetary Fund rightly emphasized that, “in all the countries, output losses were concentrated in the State sector; activity in the private sector, which is not adequately reflected in official output statistics, expanded rapidly, notably in Hungary, Poland and Yugoslavia, but it is estimated that this had little impact on the overall level of activity given the small size of the sector” [IMF, 1991, p. 27]. Even assuming that at the starting-point it was twice as large as shown by official statistics and was growing twice as rapidly as stated in those same statistics, this would still not qualitatively change the picture. Evidently, in Hungary and Poland the private sector already played more than a negligible role at the moment of entry into systemic transformation phase. Nevertheless, even in those two countries the extremely positive development trends in this sector would not be able to compensate for the huge fall in output in the public sector. In other post-socialist economies the private sector was -and remains- so modest that to illustrate it the American magazine *Time* is still obliged to photograph women selling pullovers in the streets in the centre of Moscow.

It may be noticed that as long as an insignificant recession was expected, an insignificant role was attributed to the second economy. Now that the recession has proved to be both deep and prolonged, there has been a shift in emphasis and the size and role of the unofficial economy is being excessively stressed [World Bank, 1992a]. There is no doubt that its proportions are considerable, but since by its very nature it is unknown, certain authors cannot avoid the temptation of painting it in much rosier colours than it really deserves.

Thus, efforts to underestimate the scale of production decline by means of often far-fetched exertions and dubious methodological assumptions are still being made. For example, Berg and Sachs [1992] suggest that the fall in Poland's GDP in 1991 is much smaller than it has been made out to be (3.8% instead of 7-8%) and, moreover, they attempt to explain it mainly by the output loss resulting from the decline in production previously exported to the Soviet Union. Such an approach is unambiguously apologetic in character, since it is intended to embellish reality for political and even ideological reasons. What is really involved here is the assessment of the transformation process up to the present and of the costs that it has incurred. There are persons and institutions who have an interest in exaggerating the favourable results of the transformation and its accompanying processes while at the same time brushing aside the costs as if they were of minor importance. In extreme cases, they talk about the so-called “perception error”, that is to say, the situation is better than is depicted, but people in post-socialist countries are incapable of perceiving it. As might be expected, however, we also have advocates of the opposing team who, likewise for political and ideological reasons, bias their assessments in the other direction.

The fact is that the whole process of systemic transformation and the associated real and financial processes are involved in a huge redistribution both of resources (wealth) and flows (incomes). The very tissue and structure of political and economic interests have been encroached upon and this cannot but have an influence on assessments regarding the current situation. If we accept this, then we must agree that such assessments are of a political, not a scientific character.

The above remarks -made, so to speak, alongside the main train of considerations- do, however, touch one of the key issues, namely the causes of recession and depression accompanying the market-oriented transformation of the post-socialist economy. They are complex. Initially, a series of unconnected international events were repeatedly alleged to be the principal causes of the -as far as the authors of these assessments were concerned- unexpected economic collapse. Hence, the exaggerated importance attributed to disturbances in crude oil deliveries from the USSR to the former CMEA countries and the overestimation of the impact of the Gulf conflict at the turn of 1990 [IMF, 1991]. Soon after, as the recession (and its consequences) proved to be more persistent than was originally expected, very strong emphasis was laid on the dissolution of the CMEA[6] and on the disintegration of the USSR. Both these events happened only once, however - the Soviet Union came into being only once and only once did it fall, so the above arguments are subject to rapid erosion. After all, it is difficult to explain the decline in the output of Rumania or Albania in 1992 (note - the latter had been outside the CMEA for almost thirty years) by the dissolution of the CMEA which had occurred a dozen or so months earlier or by the disintegration of USSR, rather than by the ill-prepared transition to convertible-currency settlements in mutual trade relations. What instead? And so, further "revelations" appear, namely the partial recognition of the considerable drop in output reflected by the official statistics as a real fact, but accompanied by the suggestion that this had no negative significance but quite the contrary. Particularly unconventional -or rather, odd- in this regard, is the idea that the socialist economy was in some ways overindustrialized and hence there was a need for its rather drastic deindustralization at the beginning of the post-socialist era [Berg A. and J. Sachs, 1992]. Furthermore, the idea that this process has to take place not so much through a more rapid development of the services sphere (broadly understood as the tertiary sector) as through a deep fall in industrial output and shift to the services sector of the resources thus set free. In the light of such an approach the recession is not a negative phenomenon but, in the first place, an economy-clearing process improving the aggregate product structure.

According to another interpretation -whose equally apologetic context is absolutely clear- the basis from which the fall in output was reckoned had been permanently overestimated in the past, hence the real decline in output was allegedly less than that shown by statistical data. On the other hand -since, after all, facts could not be completely denied- where the output had unquestionably fallen, it was alleged that the production concerned had been rightly eliminated because, being unprofitable, it should never have taken place at all [Winiecki J., 1991].

In this regard, a somewhat valid, though not new, observation is that a part of the lost product does not necessarily mean a real reduction in national wealth and, particularly, in the standard of living. The extent to which such an observation is true is, for methodological reasons, extremely difficult to determine precisely[7]. Two phenomena are involved here.

Firstly, a part of output decline in the post-socialist economy is the effect of getting out of the shortage economy. The mechanism of this decline works in such a way that the removal of shortages requires such control of the aggregate demand that the latter falls below the level which would hypothetically balance the demand and supply flows, since, as a rule, an inflationary overhang appears in this phase (on the eve of the entry into systemic transformation it was largest in Poland and Russia, and smallest in Czechoslovakia and Hungary) and must be neutralized (stock-balancing operations). The operation requires a larger demand reduction scale than that necessary for closing the inflationary gap alone (flow-balancing operation). As a result, the aggregate demand falls to such a degree that because of newly created macroproportions some of the existing production capacities are not utilized, since their potential product cannot be sold in the market due to the existing level of effective demand. The search for a way out of that situation without repeated intensification of inflationary processes is simply the quest for an answer to one of the questions concerning paths to growth.

Secondly, a part of the output loss results from the elimination of value-distorting production. Here, two different cases are possible. In the first, the decline in output takes place after the withdrawal of subsidies which have supported its formerly maintained level. If a product was once produced thanks only to its low price subsidized by the State, under new conditions, after the withdrawal (or reduction) of subsidies, its price will be set on a level at which a part of the output (and in certain cases even the whole output) cannot find outlets, and it is obvious that production is bound to fall. At the same time, resources are set free. If they are used within a short time for other, more effective purposes, we have a positive allocational effect and the output loss at one place is compensated by the appearance of output (or increase in the current level) elsewhere. After all, such is the aim of changes. The snag is that the desired allocational effect does not come either immediately or automatically, due to the inadequacy of market allocation mechanisms which are still underdeveloped.

Another case of reduction and elimination of value-distorting production is related to the degree and pace of the economy's opening-up and the extent of its exposure to foreign competition and application of world prices. Enterprises, which under previous conditions were capable of profitable exports, in the new context are faced with the need to reduce their production because it is not sufficiently competitive and no longer finds outlets abroad - these enterprises having previously produced a negative added value, if measured at world prices. Owing to substantial subsidies, especially for energy and many raw materials, typical of the planned economy, enterprises produced goods which were sold abroad at prices lower than those they would have secured had they sold the raw materials consumed directly at world prices [McKinnon R., 1991; Akerlof G. et al., 1991]. Hence, it is understandable that with simultaneous far-reaching liberalization of prices and trade, in some cases hitherto profitable production had to be abandoned. Although on a macroeconomic scale, this process brings gains rather than losses in the long run, in the short run the latter cannot be avoided.

Thus, four sources of recession in the post-socialist economy have been identified. They may be summed up as follows:

- firstly, the systemic and structural legacy of the economy of real socialism which gradually lost its momentum until stagflation trends appeared in its declining phase. It may be assumed -though it can hardly be proved- that if the countries of Central and Eastern Europe had not entered the systemic transformation phase, they would still have been mired in recession, although its nature and, above all, its depth and duration would have been considerably more moderate;
- secondly, external shocks some of which were of a specific character, since they were not exogenous in the full sense of the word but -at least partly-self-imposed by political decisions;
- thirdly, the effects of getting out of the shortage economy under conditions of post-socialist macroeconomic stabilization. In principle, every stabilization entails a temporary decline in economic activity [Bruno M. et al., 1989] on account of the suppression of the demand flow. It was all the more unavoidable during a stabilization process oriented not only towards a reduction of the inflation rate but also towards the removal of shortages and the introduction of a market-clearing price system;
- fourthly, elimination of value-distorting production as a result of reduction and withdrawal of subsidies to unprofitable production as well as through trade liberalization and the opening-up of the economy to external competition.

But there is also a fifth -and perhaps the most important- cause which in some countries is the most momentous factor contributing to recession and depression in the post-socialist economy. It is the economic policy and, strictly speaking, its errors consisting above all in the false sequencing of measures and overshooting of the macroeconomic stabilization [Kolodko G.W., 1992a]. If we agree that countries following a good economic policy develop twice as rapidly [World Bank, 1992b], we could venture the opinion that countries with a wrong economic policy plunge into a recession twice as deep as is really unavoidable and remain in that depression longer than necessary.

Effects of an erroneous policy in this regard can no longer be removed, but correct conclusions can, and should, be drawn from past experience and, on the basis of these, answers to questions about determinants of growth in the post-socialist economy must be sought.

2. Expectations and Reality

There is a strikingly large gap between expectations as to the character and dynamics of real systemic transformation processes and the reality. According to the most frequent expectations, the recession was to be shallow and shortlived while the phase of dynamic growth was to be entered rapidly. This mistaken view was adopted by several institutions, such as the World Bank and the International Monetary Fund and numerous individual researchers and experts. The mistake lay in cutting down the perspective and in excessive optimism. Where did this stem from?

The causes are complex here, too, and may be divided into at least five groups. The first pertains to the excessive official optimism of the new elites and their governmental bureaucracy. It was the governments, as well as parliaments, who drew up what were often absurd plans and forecasts dominated by wishful thinking and lacking a sufficient dose of realism. Insufficient professionalism, a lack of imagination and responsibility - all of these factors contributed to the formulation of unattainable goals, such as for example the assumption of a mere 3.1% decline in the national product and a 5% reduction in industrial output in Poland for 1990, or expectations of entry into the recovery phase as early as the end of 1992 in Russia. As may be supposed, politicians in these countries often knowingly proclaimed quantitative objectives which even they doubted could be attained. The reasons for this may be explained by tactical and political strategy. Although this is in some ways comprehensible in view of the circumstances, it can hardly be described as reasonable. It is understandable that no government will ever admit that its policy will, within two years, lead to a 20% fall in GNP accompanied by a 40% reduction in industrial output and the emergence of more than 10% unemployment. Even if it has the means to foresee the results of its policies and has actually foreseen them[8], such an admission would result in its being overthrown even before it has had the time to deserve it.

The second group of causes underlying erroneous forecasts and unrealistic expectations is the result of an incorrect identification and diagnosis of the realities of the post-socialist economy. To-day this state of affairs is incomparably better explored, described and identified than two or three years ago. But then again, the estimates concerning the future were based on preconceived notions and conventional assumptions rather than on solid analyses and diagnoses. It is simplistic to compare the state of affairs in post-socialist Central and Eastern Europe with that of postwar Western Europe [OECD, 1991; Wolf H., 1992] and to assume, by analogy with post-war reconstruction, that rapid growth will follow in the post-socialist economy in the same way. Echoes of such approach, though weaker, still persist, especially in some Western circles.

However, greater weight is to be attributed to the approach which treats the post-socialist economy in transformation as a system and structure typical of the developing countries. Such an approach influenced to a large extent the attitude towards the transformation processes adopted by the World Bank, the International Monetary Fund and the American Administration, as well as by the experts sent by them under the aid programs for Central and Eastern Europe, the majority of whom had never been to this part of the continent. In official documents of international financial organizations ex-socialist countries are no longer called "planned economies" but "European developing countries" (that is, undeveloped) but doubts and even objections must be raised by the fact that these countries are treated as though their socioecono-mic characteristics did not substantially differ from those of the so-called less developed countries (LDCs). Since, in accordance with such an approach -and it is to that approach that ultimately the whole transformation policy has been subordinated- the specificity of structural and institutional problems to be solved by the post-socialist world results from quantitative differences only with respect to price distortions and underdevelopment of market institutions, in particular the financial ones.

In reality, there are fundamental qualitative differences. These consist in a quite different property structure, while the fact must be stressed that the problem of a 50%

reduction in the share of the State property where that share is to be reduced from the initial 100% level (which has been the departure-point in the majority of post-socialist countries) is quite different from the situation where a similar 50% reduction is to be carried out but from an initial 60 to 30% level. Because in the latter case, there existed, even at the starting-point, an institutional market-type infrastructure, even if it was insufficiently developed. A different set of problems is to be solved by the society which attains -by way of example- a 16% unemployment level within two years having started from zero than where the unemployment reaches the same rate after doubling its 8% level. In the former case, an appropriate social security system must be created out of nothing, while in the latter case such a system, even if imperfect, already exists. Differences regarding the size of enterprises and the concentration of production in them are huge. The socialist countries were famous for their massive enterprises which employed thousands of people and in this regard, indeed, Russia always outpaced the United States, while Poland outpaced Germany and Czechoslovakia, Austria. Hence, the challenges involved in restructuring production capacities and its implications are qualitatively completely different from those in Western Europe and Japan in the postwar period [Kiyono K., 1992] or in present-day South America. Many more quantitative differences might be pointed out[9]. The point that must be stressed is that the post-socialist economy has its own distinct quality which must first be understood. Only then can economic policies aimed at its improvement be formulated. Otherwise -and this process is already under way- we will be faced with the so-called latinization of the post-socialist economies [Kolodko G.W., 1990b] and the above-mentioned differences between the post-socialist countries and the LDCs will actually become fewer, which will not, however, help diminish the problems to be solved. In short, such an analytical approach had a substantial impact on the economic policy being pursued (mainly with respect to structural adjustments) and its consequences. They were supposed to manifest themselves in a quick passage to economic growth resulting from improved allocational effectiveness chiefly achieved through rapid and far-reaching economic liberalization[10].

The third cause of false expectations and unfulfilled forecasts stems from methodological and real faultiness. Many forecasts, especially the econometric ones, were based on dubious and often hardly justifiable assumptions. For example, Borensztein and Montile (1991) accepted -basing their assumption on regression analysis- that as much as 75% of investment in the planned economy had been ineffective. The unlikelihood of such an assumption seems as obvious as it is clear that a higher level of effectiveness would have been achieved with the same investment level under conditions of market allocation[11]. But the scale of this difference is difficult, if not impossible, to estimate [Kolodko G.W., 1991b]. However, the train of reasoning is correct here. The more waste there was in the past (Flemming (1992), accepts that it amounted to 25%), the faster the growth which is to be expected in the future. The error lies in the incomplete understanding and appreciation of the conditions upon whose simultaneous realization the actual release of efficiency-oriented growth factors depends. They are so numerous that the transition-to-growth phase turns out to be much longer than is often assumed. Growth comes neither quickly nor automatically. The inefficiencies typical of the centrally planned economy are not completely eliminated but merely modified during systemic transformation. It is only in a longer term view that they can be radically reduced, and, again, this term must not be shortened, as has happened, out of unfounded assumptions regarding the possibility of rapid privatization of post-socialist economies and the stimulating impact that such property transformation will have on the sphere of real relations. Neither in the former case (pace of privatization) nor in the latter (scope of privatization) have these assumptions been fulfilled. Recently, however, more scepticism, or perhaps realism, regarding expectations in this sphere have emerged[12].

The fourth cause of excessive optimism may be briefly described as the often naive hope placed in the scale of foreign (i.e. Western) economic aid and its salutary, stimulating impact on production in post-socialist economies. Curiously enough, this belief consisted not so much in groundless expectation as to the absolute scale of the foreign aid[13] (in all its forms) as in illusions about the absorptive capabilities of the economies obtaining foreign support and about its effectiveness [Palmer M., 1992]. Many authors point out that until mid-1992 the scale of Western aid to European post-socialist countries (except the former Soviet Union)[14] had already (in comparable terms) exceeded that granted by the United States to Western Europe under the Marshall Plan after World War II [Eichengreen B. and M. Uzan, 1992; Summers L., 1992]. However, its effects are still very weak and this fact can only be explained by the mechanisms of distribution and allocation of incoming capital employed by the recipient states.

Finally, the fifth group of causes of false forecasts are of a highly subjective character and involve deliberate manipulations of public opinion which is currently unsteady and sometimes rather credulous. At the same time, economic charlatanry is rampant, presenting utterly unrealistic visions of the future, even as regards prospects for development. It is difficult to otherwise describe the promise of a one-digit inflation rate one month after the introduction of the stabilization package or the assurance of economic growth after only six months. Such visions fall on a fertile breeding-ground and shape expectations which cannot be fulfilled. The motives underlying what are sometimes outright lies are manifold, but most frequently they are of political and ideological character. Although such behaviour might be understandable, the snag is that this kind of demagoguery is not without its influence on actual political choices. Thus, it is not simply a matter of charlatans, but of the population which is to be healed by means of their artifices - making the problem a serious one indeed.

This concludes the commentary on the causes of excessively optimistic expectations of growth in the post-socialist economy. It should be noticed, however, that some expectations were justified. In particular, greater effects of certain institutional changes (for example, those relating to deregulation and competition-promoting policies as well as to general liberalization and financial reforms) and efficiency-oriented consequences of macroeconomic stabilization could and should have been expected. The disillusionment which took place in this regard was the result of an improper sequencing of institutional changes, on the one hand, and the overshooting of the stabilization policy (at least in certain countries in the region) - on the other [Kolodko G.W., 1992a; Nuti D.M., 1992; Poznanski K., 1992].

So, under conditions of an economic policy less encumbered by errors, better results could have been achieved than those actually obtained. It is in this perspective that the forecasts of the International Monetary Fund, formulated in spring 1991 in agreement with the governments concerned, should be considered; despite the fact that they, too, were to a certain extent subject to some of the above mentioned distortions (especially to those of the second and third group). In this regard, chosen macroeconomic indicators are illustrated in Table 5.

Table 5 - MACROECONOMIC INDICATORS FOR EASTERN EUROPE AND THE USSR, 1988-1996 (annual percentage change unless stated otherwise)

	1988	1989	1990	1991	1992	1993-1996
Eastern Europe^ and USSR						
Real GDP	4.3	1.9	-3.8	-4.1	-2.1	1.2
Consumer prices	11.1	30.9	34.1	45.6	18.2	-
Fiscal balance*	-8.0	-6.7	-6.5	-4.2	-	-
Eastern Europe^						
Real GDP	1.2	-0.9	-8.6	-1.5	2.8	4.4
Consumer prices	44.3	139.0	149.7	78.0	13.3	-
Fiscal balance*	-0.2	-0.1	-1.8	-0.6	-	-
Current account balance~#	6.7	3.0	-1.3	-10.0	-11.2	-
of which:						
Convertible currency	2.7	0.7	-2.8	-	-	-
Debt service ratio# (in % exports)	19.2	18.5	14.9	18.5	16.8	-
of which:						
Convertible currency	34.7	29.2	18.1	-	-	-
External debt~#"	97.9	98.4	105.0	110.2	118.3	-

^ Eastern Europe is defined to include Bulgaria, Czechoslovakia, Hungary, Poland, Rumania and Yugoslavia
* in percent of nominal GDP
~ in billions of US dollars
# includes nonconvertible currency data that are converted into US dollars at national transferable rouble (TR) US dollar rates
" excluding liabilities to the Fund
Source: *World Bank,* 1991, p. 26.

For the period that is to follow, the International Monetary Fund is formulating more cautious estimates, especially as regards economic growth rates. A similar toning down of forecasts can also be noticed in the reports of the World Bank, the OECD and the EC. It appears that conclusions are finally being drawn from past experience.

Very optimistic forecasts were sometimes put forward. At the time when the International Monetary Fund assumed, for 1991, a decline of only 1.5% in the GDP of six Central and Eastern European Countries and then, for 1992, a growth of 2.8% (see Table 5), Borensztein and Montiel (1991) forecast for Poland and Hungary a growth of 6-7% and of 3.25% for Czechoslovakia, as the yearly average for the 1991-1995 period. Almost contemporaneously, the World Bank, using other forecasting techniques [Summers L., 1992], also expected a prompt entry into the growth phase and its dynamic development in the latter half of the decade (see Table 6).

Table 6 - FORECAST OF GROSS DOMESTIC PRODUCT (GDP) GROWTH RATE (%)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Yearly
Bulgaria	-10.8	-8.0	-0.2	2.3	2.4	2.4	2.4	2.4	2.4	2.4	2.4	1.1
Czechoslovakia	-3.5	-9.8	-4.8	1.2	3.4	4.0	4.3	4.9	4.9	4.9	5.0	1.3
Yugoslavia	-7.2	-3.5	0.3	0.7	1.1	1.3	1.5	1.8	2.1	2.5	2.9	0.3
Poland	-14.0	2.0	6.0	6.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	3.2
Romania	-10.2	-4.0	1.9	2.5	3.0	3.0	3.0	4.0	4.0	4.5	4.5	1.5
Hungary	-6.5	-3.0	1.5	3.1	3.5	3.8	4.2	4.4	4.5	4.5	4.5	2.2
Non-weighted mean:												
All countries	-8.7	-4.4	0.8	2.6	3.1	3.3	3.4	3.8	3.8	4.0	4.1	1.4
Northern countries"	-8.0	-3.6	0.9	3.4	4.0	4.3	4.5	4.8	4.8	4.8	4.8	2.2
Southern countries*	-9.4	-5.2	0.7	1.8	2.1	2.2	2.3	2.7	2.8	3.1	3.3	0.6

" Czechoslovakia, Poland and Hungary
* Bulgaria, Yugoslavia and Rumania
Source: World Bank.

According to these forecasts, the GDP had to grow, for example in Poland, by as much as 6% in 1992 after a 2% growth in 1991. In reality, it fell by almost 8% in 1991 and a further decline of about 4% is to be expected in 1992. But a still greater scale of error can be adduced, essentially disqualifying not only the forecasting techniques that have been applied but also the assumptions adopted. How can we otherwise judge the forecast of nearly 14% growth in the GDP in Poland over the years 1991 and 1992 [Gomulka G.W., 1990] in a situation in which it has actually fallen in almost the same proportion over that period?

It is worthwhile to try, as an exercise, to have a look at where the materialization of some of the above mentioned development scenarios for post-socialist economies would lead.

This is also useful because it permits us to put into perspective the pathway and the distance which separates -and will continue to do so, not over years nor even a generation, but over a whole lifetime- the countries of Central and Eastern Europe from the societies of developed capitalism [Kolodko G.W., 1990c; Summers L., 1992]. The differences and hypothetical indicators illustrating the national product levels for six Central and Eastern European countries and, for comparison, those of selected OECD countries are presented in Table 7.

Those forecasts are also interesting because they show for 1991-2000 a much faster growth rate (non-weighted average) for the so-called northern countries of the region i.e. Czechoslovakia, Poland and Hungary (2.2% yearly on average) than for the so-called southern countries of the region (Bulgaria, Yugoslavia and Rumania) which started off less developed and whose GDP is assumed to grow at a modest 0.6% yearly rate. On the one hand, a future economic growth rate contributing to a reduction in the range of differences in the economic levels between Eastern and Western Europe is assumed while, on the other, a further differentiation of those levels is forecast even within the group of the European post-socialist countries (see Tables 6 and 7). Unfortunately, the latter forecast seems more realistic.

Next, let us take a look at the

Table 7 - SCENARIOS OF CHANGES IN GROSS NATIONAL PRODUCT (GNP), 1991-2000

	GNP per capita[^]			Hypothetical GNP level per capita[*]									
	1	2		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bulgaria	2,530		a	2,328	2,323	2,376	2,433	2,491	2,552	2,613	2,675	2,740	2,805
		5,430	b	4,996	4,985	5,100	5,223	5,348	5,476	5,608	5,742	5,880	6,021
Czechoslovakia	2,978		a	2,686	2,557	2,588	2,676	2,783	2,902	3,045	3,194	3,350	3,518
		7,940	b	7,161	6,818	6,900	7,134	7,420	7,739	8,118	8,516	8,933	9,380
Yugoslavia	2,460		a	2,374	2,381	2,398	2,424	2,455	2,492	2,537	2,590	2,655	2,732
		5,140	b	4,960	4,975	5,010	5,065	5,131	5,208	5,301	5,412	5,548	5,709
Poland	1,630		a	1,663	1,762	1,868	1,961	2,060	2,162	2,270	2,384	2,503	2,629
		3,910	b	3,988	4,227	4,481	4,705	4,940	5,187	5,447	5,719	6,005	6,305
Romania	1,530		a	1,469	1,497	1,534	1,580	1,627	1,676	1,743	1,813	1,895	1,980
		2,950	b	2,832	2,886	2,958	3,047	3,138	3,232	3,361	3,496	3,653	3,818
Hungary	3,028		a	2,937	2,981	3,074	3,181	3,302	3,441	3,592	3,754	3,923	4,099
		5,920	b	5,742	5,828	6,009	6,219	6,456	6,727	7,023	7,339	7,669	8,014
France	18,265			-	-	-	-	-	-	-	-	-	22,381
Germany	21,298			-	-	-	-	-	-	-	-	-	28,623
USA	21,098			-	-	-	-	-	-	-	-	-	27,007
UK	14,844			-	-	-	-	-	-	-	-	-	19,002

" in US dollars in 1990
* in 1990 prices, on assumption of growth dynamics forecast by the World Bank for 1991-2000
1 at national exchange rate (World Bank)
2 at purchasing power parity (PlanEcon)

Source: for 1991-2000 author's own calculations; for France, USA and UK on assumption of 2.5% mean yearly growth rate; Germany 3% mean yearly growth.

Table 8 - SCENARIOS OF NATIONAL PRODUCT GROWTH FOR POLAND, 1991-2000

Scenario elaborated by		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
World Bank^	a	2.0	6.0	6.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
	b	1,663	1,762	1,868	1,961	2,060	2,162	2,270	2,384	2,503	2,629
	c	3,988	4,227	4,481	4,705	4,940	5,187	5,447	5,719	6,005	6,305
Stanislaw Gomulka*	a	4.7	8.7	7.9	7.5	8.8	6.8	6.8	6.8	6.7	6.7
	b	1,678	1,825	1,969	2,117	2,303	2,460	2,627	2,806	2,993	3,194
	c	4,094	4,450	4,800	5,162	5,616	5,998	6,405	6,841	7,299	7,788
Borensztein and Montiel~	a	6.5	6.5	6.5	6.5	6.5					
	b	1,736	1,849	1,969	2,097	2,233					
	c	4,164	4,435	4,723	5,030	5,357					
Central Planning Office and International Monetary Fund, 1991	a	3.5	6.0	6.0							
	b	1,687	1,788	1,896							
	c	4,047	4,290	4,547							
Central Planning Office, 1991#	a	-9.8	-4.8	-1.8							
	b	1,470	1,400	1,374							
	c	3,527	3,357	3,297							
Actual data	a	-7.2									
	b	1,513									
	c	3,628									

a - yearly growth rate in percent where forecasts are indicated within a certain range, mean value is given
b - on 1991 basis amounting to USD 1,630 (converted at national exchange rate)
c - on 1990 basis amounting to USD 3,910 (converted at buying power parity - BPP)
Source: author's own calculations; assumed growth rates according to:
^ as in Table 6
* Gomulka S., 1990; the forecasts regard the net domestic product (NDP)
~ Borensztein E. and P.J. Montiel, 1991
# according to stipulations of The Letter of Intent of the Polish Government to the IMF, April 1991.

scatter and variability of certain forecasts, such as those regarding the growth prospects of the Polish economy, as illustrated in Table 8.

There may be some doubt as to whether the GNP level given by some forecasts for Poland, in the year 2000, will be attained at current dollar prices, let alone at fixed 1990 prices. The most obvious conclusion to be drawn should be the reluctance to make forecasts concerning the growth prospects of post-socialist economies, since here we are indeed moving on quicksand. It is all the more clear that it is time to take a closer look at problems relating to the process of macroeconomic stabilization and its links with processes going on in the real sphere. Since the latter cannot be correctly interpreted separately from the stabilization policy.

3. Macroeconomic Stabilization

It is generally accepted that, after the economic collapse accompanying the systemic transformation of the post-socialist economy, the passage to economic growth should be preceded by and coordinated with macroeconomic stabilization. What is more, the latter must simply be recognized as one of the substantial components of the process of transformation from plan to market. So the question arises - how is the notion of stabilization to be understood and what are its specific traits in a post-socialist economy? [Calvo G. and F. Coricelli, 1992; Kolodko G.W., 1992b].

According to a narrower interpretation, stabilization is understood as reducing inflation to a low level[15] and submitting it to an effective control of the monetary authorities, along with simultaneous consolidation of the mechanism of market-clearing prices. Already the specificity of stabilization in the post-socialist economy, distinguishing it from the classical Latin American stabilizations, can be noticed since in the former case a permanent removal of shortage is aimed at as well. Consequently, stabilization must be coupled with appropriate institutional changes [Kornai G.W., 1990; Edwards S., 1992]. In other words, stabilization means the overcoming of the so-called *shortagefla-tion syndrome,* a structural feature characterizing the reformed planned economies [Kolodko G.W., 1992c].

Under a broader interpretation, stabilization means the establishment of a macroeconomic system characterized by an equilibrium of flows and stocks alike. Dornbusch and Fischer [1990] define stabilization as an economic process rather than a status. It should be characterized by lack of excessive employment fluctuations and, in particular, low inflation, while certain links exist between those two categories. Elsewhere, one of the authors stresses that stabilization includes even some institutional and structural elements, pointing not only to features such as a severe tax system or a competitive exchange rate, but to sound financial markets and deregulation as well [Dornbusch R., 1991].

Thus, the broad interpretation of macroeconomic stabilization sees the establishment of such political institutional and structural factors as conditions m which the market-clearing price mechanism operates -and that at the lowest possible level of the general price index- but also as conditions in which close to full utilization of existing production capacities with reasonably full employment is feasible. To be sure, when talking about reasonably full employment a minimization of deviation from the natural unemployment rate is meant rather than a full employment policy typical of the socialist planned economy.

However, such a definition of stabilization is not sufficiently operational. First of all, such an approach neglects economic growth. In other words, stabilization without growth is possible, but so is growth in a destabilized environment. Hence, we should talk about economic growth in conditions of stabilization. And, in fact, it is just an answer to the question about the determinants of the latter configuration in post-socialist economy that we are looking for.

Macroeconomic stabilization must be reflected in the following five features which should guarantee its sustainability. And so, firstly, it is not possible to achieve and maintain economic stabilization in the face of persistent stagnationary, let alone recessionary, trends. Therefore, development processes in the real sphere are necessary, among other things, to enable indispensable budget and trade surpluses and an adequate level of labour force utilization to be obtained. Those processes must be reflected in an appropriate index of changes in the GDP level.

Secondly, the unemployment rate should be as low as possible. It is inversely correlated with the rate of inflation as well as with other economic indices, but there is no doubt that stabilization must take into account the situation in the field of employment, also because if it is too low, it has an adverse feedback on the other spheres, including budget conditions and political stability.

Thirdly, the rate of inflation must be reduced to a level which does not lead to wealth or income redistribution on a socially unacceptable scale and does not turn against output growth. The reduction in that rate to such a level must be sustainable, which should find its expression, among other things, in the curbing of inflationary expectations and the removal of structural primary causes of inflationary processes.

Fourthly, the State budget must be balanced and even show a certain surplus of revenues over expenditures. That surplus -in consideration of fiscal deficits[16] which, as a rule, exist prior to stabilization - should be kept on a level warranting the maintenance of the internal public debt within limits that can be financed in a possibly non-inflationary way. Here, a rule-of-thumb can be derived from the requirements imposed on EC countries under the planned monetary union. It is accepted that the budget balance should guarantee the reduction of the total public debt to less than 60% of the GDP within 10 years[17]. The situation in this field should be measured by the ratio of the thus defined balance to the GDP.

Fifthly, the current account balance should allow for a full and effective foreign debt service and, at the same time, create a chance of gradual reduction and elimination of the debt within a defined time horizon (for example, 10 or 25 years). Here, too, the situation will be measured by the maintenance of a certain relation to the global product.

To be sure, one can stick to a moderate debt for generations. But there have been no positive experiences in this regard, and in the case of post-socialist countries, except maybe for Rumania, the necessity for a future absolute reduction in the debt is evident, because that debt is, in itself, a destabilizing factor (see Table 9).

Table 9 - INDEBTMENT OF CENTRAL AND EASTERN EUROPEAN COUNTRIES IN CONVERTIBLE CURRENCIES

	Gross debt						
	Total[^]					Per capita[']	
	1988	1989	1990	I half of year 1991	Year 1991	1989	1991
Poland	39.2	40.8	48.5	46.0[*]	48.5	1,085	1,269
Bulgaria	8.8	10.7	11.1	11.0	11.2[~]	1,190	1,246[~]
CSFR	7.3	7.9	8.1	8.8	9.5	505	609
Romania	3.1	0.7"	1.2"	2.1"	1.5[#]	30.2"	64.5[#]
Hungary	19.6	20.6	21.3	19.7	20.4	1,947	1,974[#]
Former USSR	49.4	58.5"	62.5"	60.0"	65.0	203	240[#]
Yugoslavia	-	17.3	16.5	14.5"	17.0[~]	729	-

[^] in billion US dollars

['] in US dollars

[*] end of May 1991

[~] end of August

" end of the III quarter

[#] EEC Secretary's Office estimate

Source: *Sytuacja*, 1992.

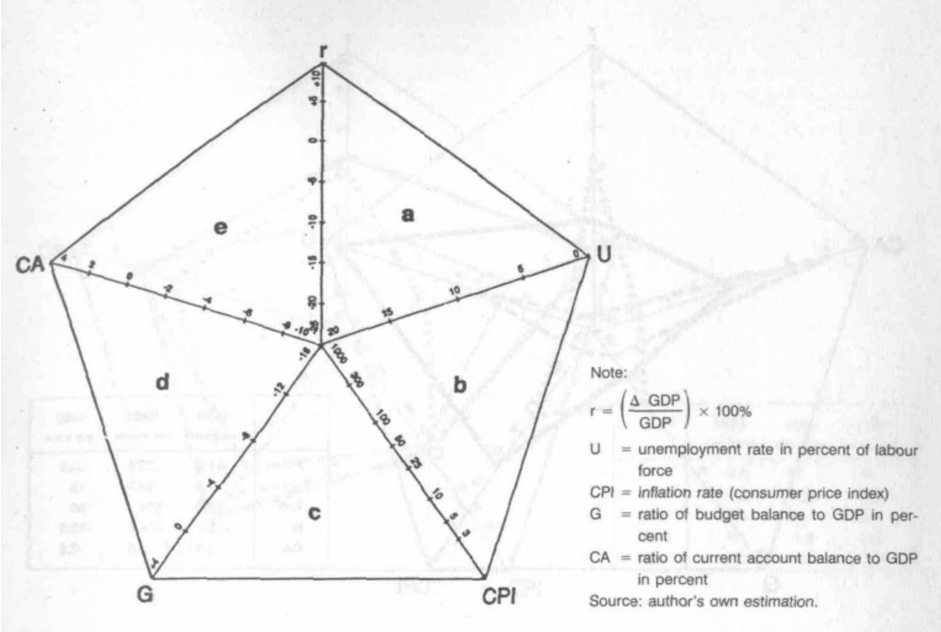
In addition, the exchange rate should be stable (which does not mean fixed) [Classen E.M. (ed.), 1991]. It is, on the one hand, an expression of stability in the previously mentioned areas and, on the other, makes the achievement of progress in those areas possible. If the above mentioned conditions were met, however, the fulfilment of the latter criterion of macroeconomic stabilization would be assured too.

The specificity of those criteria, as opposed to stabilization in market economies, mainly consists in the need to introduce a mechanism of market-clearing prices. Since, most frequently, except in some extreme situations, that problem has already been solved both in highly developed (OECD) and less developed (LDC) countries, whereas in all the post-socialist countries undertaking stabilization efforts a final and irreversible removal of shortage has not yet been achieved. As to the remaining criteria, the third one (external debt) does not pose major problems in the case of highly developed countries, whereas, curiously enough, in some cases the latter have more difficulties than the postsocialist countries (in the present phase of their functioning in curbing their internal public debt)[18].

These criteria can be represented[19] by the "macroeconomic stabilization pentagon" model (MSP). Its vertices consist of appropriately scaled parameters of the five above-mentioned criteria. Here, we assume that shortage does not exist, i.e.

$$SH = 0 \quad (1)$$

Figure 1 - MACROECONOMIC STABILIZATION PENTAGON



If it is otherwise, and this is still the case in some post-Soviet economies or in the so-called southern zone of the European post-socialist countries, instead of inflation, it is the rate of the so-called shortageflation that should be represented by the appropriate pentagon axis, even if its exact calculation poses many methodological problems [Nuti D.M., 1986; Kolodko G.W. and W.W. McMahon, 1987].

With respect to inflation, usually measured by the consumer price index (CPI) -although in some cases the use of the GDP deflator would be more justified, particularly as the latter category is also used in the present analysis-the logarithmic scale has been used. This has been done not only to facilitate presentation (during the period in question the inflation rate has a variability from 10 to nearly 600%) but also on the assumption that progress achieved by a reduction in the inflation rate, for example from 600 to 60%, is commensurate with its reduction from 60 to 6%, since in both cases the reduction in the rate of inflation is tenfold.

We also assume that there is no surplus of unsold production and unsaleable stocks. Moreover, our pentagon does not directly carry information on the formation of the exchange rate and the degree of its stability. After all, the variability of the exchange rate is a function of the pentagon's shape and area.

The vertices of the MSP are scaled so that the better the situation in a given area, the farther the particular point is situated from the centre. Hence, in some cases it is an ascending scale beginning with negative values (such, for example, is the case with respect to the current account balance, State budget, or real processes measured by the rate of GDP changes) and, in other cases, it is a descending scale tending to zero (as in the case of the unemployment or inflation rates)[20]. In spite of the obvious fact that these five criteria cannot be added together, the interpretation of information comprised in the pentagon is nevertheless transparent: the larger the area of the MSP, the better the state of affairs in the field of macroeconomic stabilization. Such a pentagon, approximating the desired ideal, is shown in Figure 1.

This pentagon consists of five triangles. The area of the first, triangle a, which may be called the *real sphere triangle,* is delimited by appropriate parameters expressing the rate of changes in the real product and unemployment. The area of triangle *b*, which can be defined as the *shortageflation (or slumpflation) triangle* depends on the rate of unemployment and the dynamics of inflation. The area of the triangle *c* (let us call it the *budget and inflation triangle}* depends on the dynamics of inflation and the State budget balance. The size of the fourth triangle, triangle *d*, which may be defined as *the financial equilibrium triangle*, results from the amount of the budget and current account balances. Finally, the area of the fifth one - triangle *e* or *external sector triangle* -is defined by the variability of the current account balance and the dynamics of the global product.

Evidently, the area of the whole macroeconomic stabilization pentagon automatically changes in step with changes in the area of any of the triangles. In general, an increase in the area of the MSP signifies an improvement in the economic situation and, on the contrary, its diminution indicates a deterioration in the condition of the economy. Thus, from the formal point of view, it is better when, for example, the area of triangle *a* (the real sphere triangle) is growing to a larger degree than the area of *d* (the financial equilibrium triangle) is diminishing. However, it should be borne in mind that such an approach suffers from a certain conventionality. Thus, the situation where

$$\mathrm{MSP} = a + b + c + d + e = l \tag{2}$$

and at the same time, the sizes of the triangles are ordered in a sequence in which

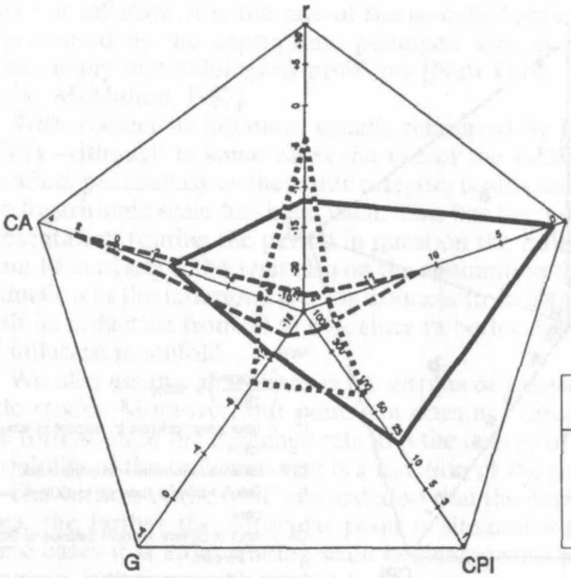
$$a>b>c>d>e \tag{3}$$

is not identical with the situation described by the inverse sequence, that is,

$$a<b<c<d<e \tag{4}$$

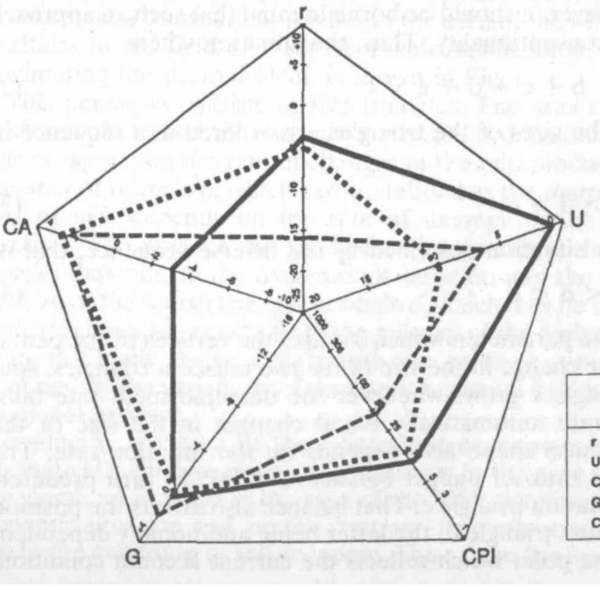
A change in any of the parameters which localize the vertices of the pentagon entails an immediate change in the size of the two adjacent triangles. And so, the real sphere triangle *a* grows whenever the unemployment rate falls, changes in the latter rate automatically entail changes in the size of the stagflation triangle *b* whose shape also depends on the inflation rate. The carter, together with the ratio of budget balance to GDP, in turn predetermines the area of the inflation triangle *c*. That balance also affects the position of the financial equilibrium triangle *d*, the latter being additionally dependent on the localization of the point which reflects the current account condition.

Figure 2 - MACROECONOMIC STABILIZATION PENTAGON BULGARIA 1990-1992



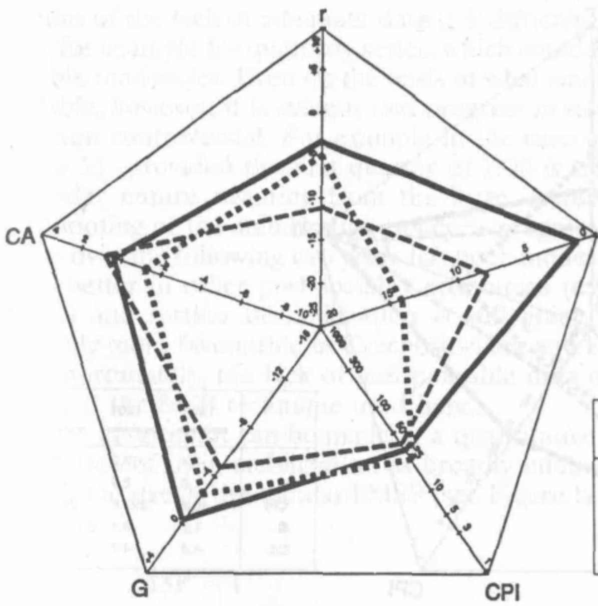
	1990	1991	1992
r	-11,8	-22,9	-4,0
U	1,0	12,0	18
CPI	19,3	574	80
G	-12,7	-14,9	-10,0
CA	-2,8	2,0	-7,5

Figure 3 - MACROECONOMIC STABILIZATION PENTAGON CZECHO-SLOVAKIA 1990-1992



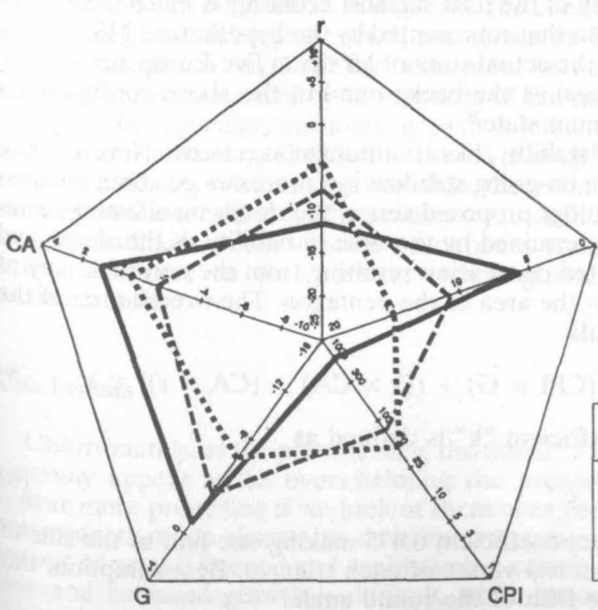
	1990	1991	1992
r	-4,1	-15,9	-5,0
U	1,0	6,6	10,0
CPI	10,0	45,3	12,0
G	0,2	1,9	0
CA	-2,9	2,8	3,0

Figure 4 - MACROECONOMIC STABILIZATION PENTAGON HUNGARY 1990-1992



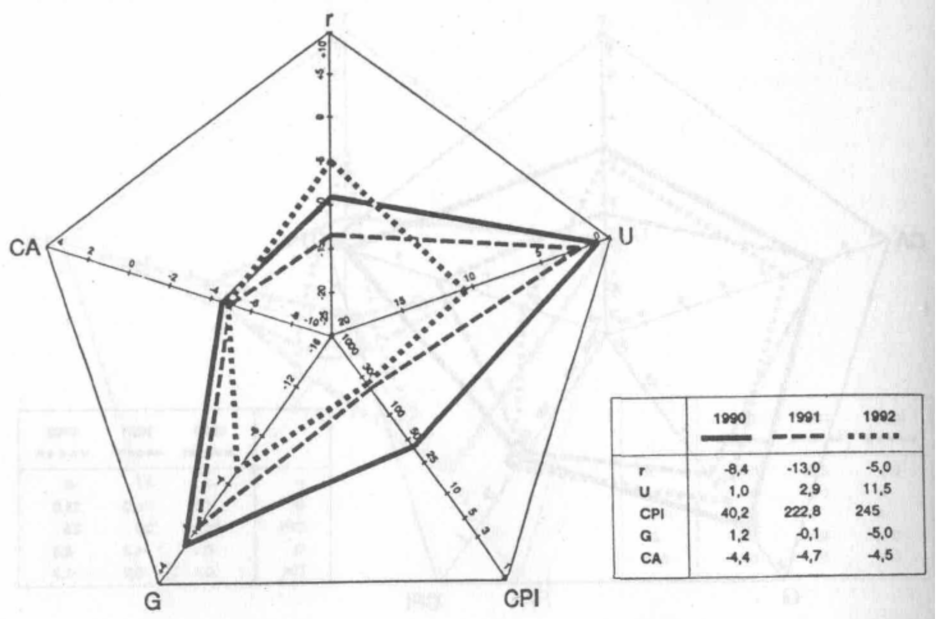
	1990	1991	1992
r	-3,3	-11	-5
U	1,6	8,0	14,0
CPI	28,9	35	25
G	0,1	-4,5	-2,3
CA	0,4	0,8	-1,3

Figure 5 - MACROECONOMIC STABILIZATION PENTAGON POLAND 1990-1992



	1990	1991	1992
r	-11,6	-7,5	-4,8
U	6,1	11,4	15,0
CPI	585	70,3	48,0
G	0,4	-3,8	-5,6
CA	1,0	-1,8	-0,4

Figure 6 - MACROECONOMIC STABILIZATION PENTAGON RUMANIA 1990-1992



	1990	1991	1992
r	-8,4	-13,0	-5,0
U	1,0	2,9	11,5
CPI	40,2	222,8	245
G	1,2	-0,1	-5,0
CA	-4,4	-4,7	-4,5

Finally, the latter, together with the index of real sphere dynamics which was our departure point, determines the size of the external sector triangle *e*.

Unfortunately, the reality of the post-socialist economy is much more complex and less favourable than that represented by the hypothetical MSP shown in Figure 1. In Figures 2-6, the actual state of affairs in five European post-socialist countries is shown against the background of the above configuration symbolizing the near-optimum state[21].

Of course, the notion of stability, like its antonym, is relative. Nevertheless, we may talk either about an on-going stabilization processes or about destabilization. Using the methodology proposed above, the trends manifesting themselves in this regard are determined by the time variability of the shape and -bearing in mind the adopted convention resulting from the non-additivity of the five indices being used- the area of the pentagon. The overall area of the MSP is given by the formula

$$[(r \times U) + (U \times CPI) + (CPI \times G) + (G \times CA) + (CA \times r)] \times k \qquad (5)$$

where the value of the coefficient "k" is defined as

$$k = 1/2 \sin 72° \qquad (6)$$

Therefore, it is a constant coefficient 0.475 making one-half of the sine of the angle situated at the central vertex of each triangle. By assumption, this angle is 72 degrees i.e. one fifth of the round angle.

Unfortunately, we have at our disposal a very short time series which in practice does not allow us to formulate conclusions of a general nature. On account of the lack of adequate data it is difficult to draw appropriate pentagons, for example for quarterly series, which could facilitate the observation of possible tendencies. Even on the basis of what small amount of information is available, however, it is evident that progress in stabilization has been modest and even controversial. For example in the case of the Polish economy (see Figure 5) -

provided the first quarter of 1990 is treated separately due to its particular nature resulting from the huge corrective inflation and general overshooting of the stabilization policy[22]- progress in macroeconomic stabilization over the following two years has been modest. The state of affairs is not much better in other post-socialist economies (especially in the post-Soviet Union) and further destabilization is still going on, while the situation is relatively more favourable in Czechoslovakia and Hungary (see Figures 3 and 4). Unfortunately, the lack of indispensable data precludes its illustration by means of the MSP technique used here.

Thus, an attempt can be made at a quantitative measurement of progress, or the lack of it, in stabilization as broadly understood. Here, the reference point is the size of the standard MSP (see Figure 1). On the assumption that in that case

$$MSP = 1 \qquad (7)$$

the situation varying in time (different years) and space (different countries) illustrated in Figures 2-6 can be, first, quantified according to formula (5) and, then, referred just to that unity. The coefficients thus calculated (to distinguish them they may be referred to as *msp)* and the coefficients of triangles *a, b, c, d* and *e* which are their components, are shown in Table 10.

A certain amount of feedback takes place between the processes reflected in the information carried by the vertices of the macroeconomic stabilization pentagon. In particular, economic growth is influenced by the remaining phenomena and processes analysed above. A strengthening of that influence is desirable, among other things, so that the economic growth process thus initiated and intensified might assume some definite characteristics. A great and, in conditions of post-socialist economies under transformation, very important influence on the character of that growth is always exerted by the economic policy.

4. Conclusions

Unfortunately, at the present time, the threats which beset the post-socialist economy appear to be overwhelming the prospects of growth. The latter paper more promising if we look at them over the longer term, yet this does not mean that the threats to development processes will be removed. The pursuit of an enlightened and sophisticated economic policy aimed at sustain-and balanced growth is difficult, while committing errors which entail destabilization and economic stagnation is easy - all the more so, the less professionally equipped the new political elites and management echelons.

The practical experience of other economic systems have taught us that the transition from stabilization to growth is not automatic. A skilful economic policy pursued by the State and efforts on the part of the society at large are required. Equally important is the support provided by the external world. The post-socialist economy is no exception, but in its case the situation seems still more difficult. Putting aside the difficulties in macroeconomic stabilization, which proved far greater than expected, the release of the growth mechanism requires a greater effort in the field of structural adjustments than in the case of underdeveloped market economies.

Table 10 - MSP MACROECONOMIC STABILIZATION COEFFICIENTS, 1990-1992

	Coefficient	1990	1991	1992
Bulgaria				
	a	0.072	0.005	0.012
	b	0.109	0.006	0.007
	c	0.019	0.001	0.022
	d	0.017	0.009	0.011
	e	0.039	0.010	0.021
	msp	0.255	0.032	0.073
Czechoslovakia				
	a	0.113	0.035	0.057
	b	0.127	0.060	0.064
	c	0.108	0.080	0.102
	d	0.082	0.164	0.149
	e	0.061	0.048	0.106
	msp	0.491	0.386	0.478
Hungary				
	a	0.114	0.048	0.034
	b	0.094	0.058	0.032
	c	0.083	0.056	0.073
	d	0.120	0.089	0.085
	e	0.092	0.062	0.071
	msp	0.503	0.312	0.296
Poland				
	a	0.053	0.043	0.029
	b	0.011	0.033	0.022
	c	0.013	0.047	0.046
	d	0.129	0.071	0.071
	e	0.060	0.059	0.079
	msp	0.266	0.253	0.247
Romania				
	a	0.090	0.059	0.049
	b	0.088	0.037	0.017
	c	0.080	0.035	0.022
	d	0.069	0.060	0.043
	e	0.038	0.026	0.045
	msp	0.365	0.217	0.176

Source: author's own calculations

Critics of the traditional approach to structural adjustments stress that its advocates and practitioners simply assume that the market by itself will secure the availability of organizational (managerial) and technological skills necessary for an effective functioning of private enterprise. That is not the case, however, and hence the arbitrary assumption that the basic factor for sustain-able growth, namely, human capital equipped with desirable skills, cannot be adopted and it is the State which must foster its development [Pegatienan J.H., 1991]. It seems that in this regard the post-socialist economy is in some cases in a better position and in some other cases in a worse position than that of the underdeveloped market economies; since, in general, the education level of the post-socialist societies is relatively high, though often ill-matched to the needs of the market economy. However, it may be estimated that the adaptation process in this sphere is proceeding quite quickly and the generally high level of schooling and education of the labour force appears to constitute a factor conducive to the intensification of growth and utilization of the advantages of the market economy.

It may seem that economic populism is one of the serious threats to the efforts directed towards stabilization and inducement of sustainable growth. It is defined as, “...an approach to economics that emphasizes growth and income redistribution and deemphasizes the risk of inflation and a deficit finance, external constraints, and the reaction of economic agents to aggressive nonmarket policies” [Dornbusch R. and S. Edwards, 1991, p. 9]. Those authors point out three phases of a populist economic policy.

During the first phase, politicians are fully confirmed in their belief in the Tightness of their approach, diagnoses and recipes. Output grows, real wages rise, employment is maintained at a high level. Inflation is kept under effective control, there are no shortages, owing above all to the financing of imports with existing foreign exchange reserves or to the deferment of foreign debt repayments.

In the second phase, the economy falls into numerous bottlenecks, both as a result of a strong expansion in the demand for domestic goods and due to the growing shortage of convertible currency. While during the first phase the decline in stocks was a desired phenomenon, it now starts to constitute a problem. Price adjustments, devaluation of the exchange rate and reintroduction of its administrative control become indispensable. Inflation increases and the budget deficit deepens.

In the third phase, severe shortages and drastic acceleration of inflation as well as a shortage of convertible currencies lead to the flight of capital and demonetization of the economy. The condition of the budget deteriorates still further as a result of the decline in real tax revenues and increased subsidies. Real wages substantially fall as a result of the government's stabilization efforts but the latter no longer bear fruit.

Finally, in the fourth phase, recourse to orthodox stabilization is necessary, mainly through the use of IMF programmes. Real wages must fall to a still greater degree, well below the level current at the starting-point of the whole cycle. The situation is also more difficult now because there has been a flight Capital, the latter being internationally mobile, while the labour force remains at home. Obviously, the new orthodoxy is already being implemented by new government [Dornbusch R. and S. Edwards, 1991].

The history of economic populism in Latin America is not short, but seems to be coming to an end, since it has compromised itself for good.

Finally, six conclusions can be formulated which arise from the whole debate on the determinants and implications of stabilization, recession and growth in the post-socialist economy. Firstly, the perspective must not be reduced, since the processes in question are, by their very nature, long-term ones, and errors in economic policy committed during the systemic transformation serve to prolong them further still.

Secondly, one must not expect too much - still less promise it to others. If favourable and desired effects do appear it is better they should surpass expectations rather than painfully disappoint.

Thirdly, one must count on self-reliance in the first place. The economic reasons of State call for a permanent increase in the propensity for saving in societies engaged in market-oriented transformation of the economy as well as for the intensification of the investment effort which can be assisted only -and then on a limited scale- from external sources of financing the growth.

Fourthly, one must learn as much as possible from others, since most of the errors which could have been made have already been committed somewhere in the past. So, learning from one's own failures should be minimized, and appropriate conclusions should be drawn from other people's errors. Unfortunately, evidence for such a drawing of conclusions is not in short supply. What is worse, in connection with the on-going post-socialist transformation, still more of it is accumulating, though hopefully as little as possible.

Fifthly, despite the fact we are talking about the post-socialist economy as a kind of subsystem of the world economy, a uniform course of events must not be expected within it, neither with respect to macroeconomic stabilization nor with respect to sustained economic growth. Some countries will be more successful, others less so, and in the foreseeable future the state of affairs within the whole group may become still more differentiated.

Finally, the future should be optimistically perceived in the long run. More facts speak of probable success of the transformation process as a whole which gives chances of a balanced and sustainable economic growth and social development. Whether that chance is missed or not depends, above all, on the State's enlightened, imaginative, active and responsible economic policy and strategy.

This paper was received in July 1992.

Notes

[1] It is to be expected that the process is not yet completed. In the monograph devoted to stabilization in a post-socialist economy [Kolodko G.W., Gotz-Kozierkiewicz D. and E. Skrzeszewska-Paczek, 1992], the interesting case of Vietnam was also discussed, this case being however considered to be a reformed socialist economy. But there are many signs indicating that this country too will join the group of post-socialist economies. Although as recently as in the newly voted constitution of April 1992, there is mention only of a transitional period *from* capitalism to socialism, not the reverse, the country is actually moving in the opposite direction, judging by the character and pace of the fairly consistently implemented economic reforms - which are, however, not supported by appropriate political reforms.

[2] The term *transformation process* refers to a transition from a socialist to a capitalist economy, and not a reform aimed at improving the socialist economy [Brus W. and K. Laski, 1989]. Therefore, a period following the socialist phase is denoted [Kaminski B., 1991].

3 Of course, one must be aware of the errors and methodological unreliability of much official statistical data representing the economic growth in the period 1950-1989, but I do not think that the resulting alterations can be of qualitative importance.

[4] Strictly speaking, in some cases the downturn had taken place in 1989. For example, in Poland, the sold production of the socialized industry, i.e. the basic macroeconomic aggregate determining the dynamics of the aggregate product, had begun to decline in absolute terms in May 1989. Therefore it may be assumed that the GDP was already falling in the latter half of that year.

[5] The situation is similar in the above-mentioned growth cycles typical of the centrally planned economy, as well.

[6] Usually, the dissolution of the CMEA is presented as an external shock. Such an approach is not fully justified, since that organization was dissolved by the free will of the countries concerned (or, rather, their ruling politicians). That this was probably the worst way of dissolving it is witnessed, among other things, by the fact that the problem of regional cooperation reappeared soon afterwards. This problem could have been approached in a much more judicious manner than actually occurred. Many proposals to this effect were, unfortunately, ignored by politicians [van Brabant J., 1990; Rosati O.K., 1992].

[7] It is still more complicated since, during the transformation, a certain decline in consumption level takes place (i.e. precisely as a result of economic recession) but, at the same time the country gets out of the shortage economy. So, there are two processes, opposite as to their impact on the standard of living, but in the short run their result is negative.

[8] In some cases, preconditions for this existed. In Poland, there had been warnings against the possibility of collapse - which subsequently materialized more or less [Kolodko G.W., 1991a; Laski K., 1990], but these warnings were ignored and, later, government circles almost exclusively blamed forecast errors rather than the policy errors which were the basic cause.

[9] Sometimes, those differences manifest themselves in a rather unexpected way. In developing countries the ratio of salaries of the ruling bureaucracy elites to the per capita aggregate product reaches as much as 130:1, for example in Nigeria (compared with 8:1 in the U.S.A.) [Abernethy D.B., 1988], which contributes to the passage of well-educated personnel from the private sector to the state administration. In post-socialist economies the situation is quite the opposite. Income proportions are such that the developing private sector simply sucks professionals from the government sector, with all the adverse implications that this involves for the operational efficiency of the social services sector and, in the longer run, for economic growth, too. On the other hand, this may bolster the development of the private sector and favourably influence economic growth. The short-term result of those countertrends is difficult to assess.

[10] Such a point of view prevails in Western Economic thought with respect to growth prospects following every stabilization [Dornbusch R., 1991], though also meeting with justified criticism [Pegatienan J.H., 1991] which points to the specificity of political institutional and structural environments which sometimes require a different course of action.

[11] At the same time, it is being suggested that, under the conditions created by the new system, a better allocation of resources should take place in favour of exportable consumer goods, while leaving the investment mainly to foreign firms and those enterprises who use the imported capital goods where this is economically justified [Flemming J., 1992]. The above opinion is controversial, since I do not see sufficient arguments to back such a distribution of tasks between the domestic and foreign capital. Because, in certain situations, the former can prove more competitive in the investment market as well.

[12] *The Economist*, for example, stated that, "...even if the sell-off succeeds, its benefits will not be visible for months, perhaps years. Unmistakably, the first results of mass privatization will be bankruptcies, closed factories

and lost jobs" *[The Economist*, 1992, p. 13]. That is a correct, though in those columns quite new and very tardy view, since earlier rapid privatization had been regarded as a panacea which would produce economic advantages, including increased output, almost immediately.

[13] In the summer of 1989, the so-called Trzeciakowski Plan was well known in Poland; it assumed an inflow of $10 billion U.S. over three years, inclusive of the reduction in external debt. At that time, those proposals were not treated sufficiently seriously, either at home or abroad, since they were supposedly unrealistic. Three years have passed, and the scale of foreign aid has been even greater, but its effects have been incomparably less than expected.

[14] It is worth realizing that granting aid to the former Soviet Union comparable to that obtained by the former GDR in 1991, would cost about $1 trillion U.S. Obviously, that would not prevent the collapse in production, which is witnessed by the example of the more competitive economy of the

[15] Such a definition is not precise. For example, in New Zealand the goal of less than 2% inflation in yearly scale was set (and was already achieved in 1991). In many post-socialist countries this goal is often defined as a one digit yearly inflation rate or a price rise rate of less than 1% monthly.

[16] Those deficits also appear soon after the implementation of the stabilization package, though not necessarily immediately after. This is particularly evident both in the case of the Polish economy which has applied the "cold turkey" approach to macroeconomic stabilization and with respect to the Hungarian economy which has chosen the path of gradual stabilization, including gradualist fiscal adjustment. Several years of a fiscal disequilibrium period is to be expected during the initial transformation period [Gotz-Kozierkiewikz D.G. and G.W. Kolodko, 1992; Tanzi V., 1992]. While the budget equilibrium state - as in Poland in 1990 or in Czechoslovakia in 1991- is a rather transitional state of affairs.

[17] For example, in Poland 1992 the public debt is estimated at a little more than PZL 900 trillion (about $64 billion U.S.) which makes it 69% of the GDP. In other post-socialist economies it is still less. However the fact of the matter is that the trend towards an increase in this debt is becoming stronger and stronger.

[18] In 1991, the public debt level in Poland was lower than in countries such as Italy (103.8% of GDP), Belgium (131.5%) and Ireland (113.1%). On the contrary, it was higher than in Japan (63.4%), USA (58.6%), Federal Republic of Germany (43.9%), United Kingdom (36.7%), Spain (45.3%) and Finland (18.6%) *[Centralny*, 1992, p. 28].

[19] Attempts at such a representation of the economic situation have already been undertaken - in other contexts- i.e. with regard to the research on business cycle fluctuations [Marczewski K. and I. Zagozdzinaka, 1990] or long-term economic trends *[The Economist*, 1991].

[20] It is assumed that the appearance of deflation and decline in the overall price level is not realistic in this scenario of post-socialist stabilization. Likewise, a labour shortage is not possible. Maybe, instead of assuming a zero unemployment, one should arbitrarily anticipate a certain desired natural unemployment rate, but for the sake of simplification, I neglected this problem here, while understanding as zero unemployment rate one which essentially corresponds to the economically justified natural rate of unemployment.

[21] The sources of information being presented are not uniform. For Bulgaria and Rumania, they are mainly IMF data, while with respect to inflation estimates for Rumania, point-to-point indicators have been calculated on the basis of information obtained from *PlanEcon [PlanEcon*, 1992]. For Poland, data come from the Central Statistical Office. In the case of Czechoslovakia, information was obtained from the Ministry of Economy, and for Hungary, from the Economic Research Institute in Budapest. Some indicators, especially those comprising 1991, are estimates. Many of them raise serious methodological doubts [Berg A., 1992], hence they are not always fully reliable. As to the forecasts for 1992, in most cases they come from the same sources as the statistical data being used here. Wherever the forecasts have been given within a certain range, the arithmetical mean has been used. For those reasons, the results which are presented here must be treated with great caution, since they will require verification in future.

[22] The snag is that the policy-induced rise in prices by more than 140% in the first quarter of 1990 in comparison with their December 1989 level distorts to a very high degree the inflation image, namely because of the statistical averaging of the price index. While in a yearly scale the CPI amounted to about 250%, its level, on a yearly scale and excluding the first quarter, amounted to only 72%. And from that level there was practically no further reduction during 1991 when inflation amounted to over 70% as well. The situation has not significantly improved in 1992 either.

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