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STABILIZATION, RECESSION AND GROWTH IN POSTSOCIALIST ECONOMY

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Contents

Tables

Figures

Summary

The process of systemic transformation from planned economy to a market economy comprises three different planes: macroeconomic stabilization, institutional changes and microeconomic restructuring of the production capacity. Although, in analyzing the systemic transformation we are mainly concerned with the organization of that process and the control of its course, it is evident that, in the long run, the supreme objective of the whole undertaking is the formation of political, institutional and such structural conditions which will be conducive to higher economic efficiency and, consequently, will enable a sustainable growth.

Here, a special importance is acquired by the transition from stabilization and processes which acompany it in conditions of market-oriented transformation — especially including a considerable fall in the level of economic activity finding expression in a decline in output and growth in unemployment — to the phase of economic growth. However, to reveal the mechanism and determinants of that transition, a detailed identification is required of the nature of the recessionary processes in the postsocialist economy, their determinants, mechanisms and effects, and particularly their duration. It is against that background only that directions of further transformation measures can be suggested; the latter should be compatible with stimulation and sustainability of development trends.

In particular, the considerations must concern the problems of the level and structure of savings, the mechanism of their transformation into capital as well as the ways of the latter's effective allocation in conditions of only emerging market institutions. Also, the question arises about the role of external sources in financing the development.

It is in the above aspects only that the threats and prospects of long-term sustainable economic growth can be discussed. There should be no doubt that the scale of output decline as well as the prospects of production growth are a function not only of the existing and radically changing economic and political system but also, in the first place, of the economic strategy and policy. Their character seems to have a decisive importance.

1. Causes and scale of recession in postsocialist economy

The postsocialist economy is an economy in which an irreversible process of transformation from planned allocation mechanism to a market-type one is going on along with the associated development of a democratic, pluralistic society. This process has already spread over more than twenty states, inclusive of the post-Soviet countries. The remarks and conclusions which will be formulated here regard, in principle, the whole group of those countries, although in many cases empirical data sufficiently reliable to draw up some generalizing judgements are not yet available. What is more, the process in question still is in statu nascendi and, therefore, any too far-reaching generalizations would be fraught with 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. Let us mention just two of the whole bulk of differences: in the former case we are at the very beginning of the market-oriented transformation process, and that at the starting-point in the form of the traditional Soviet economy, though largerly disintegrated and entangled in an extremely vast political, institutional and structural upheaval.

In the latter case, the market-oriented transformation process already is to a large extent qualitatively advanced and the starting-point, too, was considerably different because of the previous significant progress in market-oriented reform of the socialist economy in those countries. Irrespective of how those reforms are assessed, there is no doubt that they facilitate the market-oriented transformation process (Nuti, 1992). In awareness of those and many other differences (Bozyk, 1992) it is nevertheless worth trying to answer the question about the general conditions, interrelations and prospects of stabilization and economic growth in the postsocialist economy.

While, from the spatial point of view, the notional scope of the postsocialist economy has been widening in the course of the last few years[1], 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 postsocialist economy, I will mean that period in particular and the European postsocialist countries in the first place.

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[1] It is to be expected that the process is not yest completed. In the monograph devoted to stabilization in postsocialist economy (Kolodko, Gotz-Kozierkiewicz, Skrzeszewska-Paczek, 1992), the interestoing case of Vietnam was also discussed, this case being however considered to be a reformed socialist economy. But there are many signs indicating that that country too will join the group of postsocialist economies. Although, still in April 1992, there was in the newly voted constitution talk about transitional period from capitalism to socialism and not the other way round, it is rather the latter direction that it witnesses by the character and pace of the fairly consistently implemented economic reforms. However, they are not supported by apropriate political reforms.

[2] By the transformation p[rocess I understand the transition to capitalistic economy from the socialis one, and not a reform aim ed at improvement of the latter (Brus, Laski, 1989). So, a period following the socialist phase is meant (Kaminski, 1991).

Table 1

Economic growth cycles in socialist countries (average yearly national product growth rates)

Country	Periods / Growth rate (in percents)									
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
		–	+	–	+	–	+	–	–	+
Czecho-Slovakia	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		
	18.0	8.2	11.6	6.0	8.2	6.5	5.0	3.3		
		–	+	–	+	–	–	–		

... – data not available
"+" – acceleration
"–" – slow-down

Source: Rocznik Statystyczny (Statistical Yearbook), Warszawa: GUS (different years). Own calculations.

Before posing questions about the present day, let us have a look at indicators illustrating the dynamics of past development processes in the planned economies. This is necesary, among other things, because at present we often have to do with a kind of amnesia finding expression in forgetting the fact that over most of the period of the so-called real socialism there was a rather high – by contemporary international standards – dynamics of national product. The present views on that dynamics[3] are – on the one hand – formed under the impression of the low rate of economic growth during the decline phase of real socialism, and – on the other hand – are deliberately formulated out of political and ideological motives. Since, the belitteling and negation of the past economic growth can put the contemporary processes and their political assessment in a different context. I do not think the effect of such a psychological maneouvre can last for a long time, nevertheless it has been frequently used – from Warsaw to Ulan Bator.

One of the characteristics of the economic growth process in the centrally planned economy was its cyclic character understood as endogeneous oscillations of the growth rate round a long-term ascending trend (Kolodko, 1975 and 1986). So, as illustrated in table 1, periods of higher and lower dynamics alternatively followed each other.

A distinct weakening of development dynamics in the late 80s was an undisputed fact. What is more, it was accompanied by increasing destabilization finding expression, among other things, in acceleration of price inflation processes, growing shortages and deepening external disequilibrium. It is understandable that a negative feedback among those processes took place and its results are felt till to-day. 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, 1989). However, we had not yet to do with an output decline in those countries (table 2).

Except for the Romanian – and to a lesser extent – Hungarian case, the fall in global product has appeared beginning with 1990 only[4]. A clear collapse was visible in that and the two following years, parallelly with simultaneous decline in growth dynamics in the developed market economies (table 3).

The fact is that the recession has only appeared along with the entry into the phase of systemic transformation. This could lead to the conclusion that the decline in economic activity has been directly connected with systemic transformation. And so, the question arises whether it is really so and to which extent the fall in output in the postsocialist economy is a function of the transformation and its three components i.e. macroeconomic stabilization, institutional changes and microeconomic restructuring of production capacities? Or, to which degree can that fall be explained by other factors? Since, it is only on the basis of correct answers to the above two questions that ways out can be sought permitting to enter the pathway to growth.

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

[4] Strictly speaking, in some cases the turn took place in 1989 already. E.g. in Poland the sold production of the socialized industry, i.e. the basic macroeconomic aggregate determining the dynamics of global product, was declining in absolute terms beginning with May 1989. So, therefore it may be assumed the GDP was falling in the latter half of that year already.

Table 2

Basic macroeconomic indicators for European socialist countries

		Net national product (growth rate)	Inflation (CPI) in percents	Current account balance (in % of NNP)
Bulgaria	1970-1979	7.1	0.7	r.d.n.a.*
	1980-1989	4.0	3.3	r.d.n.a.
	1984-1989	3.8	2.8	-2.7[g]
Czecho-Slovakia	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[d]	1970-1979	6.1	17.5	-2.0
	1980-1989	0.7	74.9	-0.1[e]
	1984-1988	0.6	106.3	1.5[f]
Poland	1970-1979	6.7	4.1	r.d.n.a.
	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[a]
	1980-1989	4.5	3.8	0.7[b]
	1984-1989	5.8	0.2	3.1[c]
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

[a] 1977-1979 percentage of gross national product (GNP) instead of net national product (NNP)
[b] 1980-1986 percentage of GNP instead of NNP
[c] 1984-1986 percentage of GNP instead of NNP
[d] gross real product instead of GNP
[e] 1980-1986
[f] 1984-1986
[g] 1985-1988
* reliable data not available

Source: national statistical yearbooks (different years). Own calculations.

Table 3

Dynamics of national product (NP) and gross domestic product (GDP) in chosen countries in 1981-1992

in percents

		Rate of changes						
		yearly average			preceding year = 100			
		81–85	86–88	89–91	1989	1990	1991	1992 forecast
Poland	NP	−0.8	3.8	7.86[a]	−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[d]	0.0
Hungary	NP	–	–	–	–	–	–	–
	GDP	1.7	1.8	−4.5	−2.0	−3.3	−8.0	0−1
USSR[b]	NP	3.2	2.8	−5.7	2.4	−4.0	−15.0	–
	GDP	–	–	–	–	–	−17.0	–
Yugoslawia	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	"	3.9	4.2	4.9	4.7	5.6	4.5	2.4
FRG[c]	"	1.2	2.6	3.8	3.8	4.5	3.2	1.8
France	"	1.5	2.7	2.7	3.9	2.8	1.4	2.1
Italy	"	1.5	4.0	2.0	3.0	2.0	1.0	2.0
UK	"	1.9	4.2	0.4	2.3	0.8	−1.9	2.2
Spain	"	1.4	4.6	3.6	4.8	3.7	2.5	2.9
Portugal	"	0.8	4.2	4.0	5.4	4.2	2.7	2.6
Finland	"	2.8	3.8	0.1	5.4	0.4	−6.2	−0.4
OECD	"	2.3	3.5	2.3	3.4	2.6	ca−1.0	ca−2.0
EEC	"	1.4	3.1	2.5	3.5	2.9	1.3	2.1

[a] 2 years 1989–1990
[b] data for Community of Independent States (CIS).
[c] without former GDR
[d] according to recent informations, the GDP has fallen by 5.8%, which seems improbable in the light of other indicators.

Source: Sytuacja (1992).

But before doing so, one more question is worth posing: can the course of real processes in the postsocialist economy in the early 90s be defined as recession? There are authors who deny the suitableness of this definition to describe the quality of phenomena in which we are at present entangled in Central and Eastern Europe, while stressing their specific, or even unique character. With such an approach the notion of recession is, in principle, exclusively reserved for a specific phase of business activity cycle typical of market economy. The postsocialist economy – by its very nature and definition – is not a market economy; it also is not a planned economy any more (Kolodko, 1990a). Then, by recession we understand a phase of lowered economic activity during which the absolute GDP level declines. According as 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 the modern cycle. In such a perspective, the emphasis is laid on a certain regularity of the process, though recently it is far away from the regularity typical e.g. of the natural or astronomical cycles.

However, more important than the relative regularity is here the mechanism of transition from one phase to another. And so, in the business activity cycle[5] this mechanism has an unambiguously endogeneous character. Already in the recovery phase prerequisites of future economy overheating and relative or absolute decline in output level are inherent. And inversely, in the recession phase prerequisites of transition to the recovery phase are present which in the classical cycle was preceded by a depression phase. And so, in the case of postsocialist economy we certainty have to do neither with such a character nor with such a sequence, although a comparison with the classical cycle may to a certain extent arise. But the most important statement to be made at this point is that in the postsocialist economy there is no automatism in overcoming the phase of low economic activity, while such a mechanism is inherent in the business cycle typical of the market economy. From such a perspective, one really should not talk about recession, but give that process a different name. But I do not see such a need, since the problem does not consist in devising new definitions but in a proper interpretation of the developments we are entangled in. So, let us accept that we have to do with recession, but one whose nature is different from that of classical recession as a phase of business cycle in the capitalist market economy.

The recession typical of postsocialist economy is characterized by the following features:

- firstly, it follows the phase of low economic activity (with propensity for stagnation) typical of the cyclical character of growth in the socialist economy;
- secondly, it manifests itself, among other things, in an absolute decline in output and investment level (though not necessarily in other macroeconomic aggregates, e.g. exports);
- thirdly, in this case, the mechanism of automatic transition to the postrecession recovery phase does not work;
- fourthly, the sequencing of phases which follow the recession is not predetermined. It sometimes may be a sequence rather similar to that of modern business cycle in

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

developed capitalist economy, which means that immediately after the decline in output the economy enters the recovery phase. It also may happen – what is more probable and its symptoms are already visible well enough in at least some postsocialist countries – that recession will be followed by depression which, after passage through recovery, will lead to prosperity. It is only then that growth will follow and its course will be more or less like in modern business cycle in capitalism.

I think that, in reality, the events will follow – and in principle already are following – the latter scenario, which is being witnessed by a number of facts. In some Central and Eastern European countries – e.g. in Bulgaria, Czecho-Slovakia and Poland – the very low production activity is already persisting long enough to permit to talk about the appearance of the postrecessionary depression phase. The latter is characterized both by the lack of any clear trend towards a further output decline and the absence of signs of growth trends. In other words, there is stagnation on a very low level accompanied by further growth in unemployment. That has already become a specific feature of depression in postsocialist economy distinguishing this phenomenon from its classical course (Kolodko, Rutkowski, 1991); trends present in this field are shown in table 4.

However, the sequencing and intensity of particular phases will be ultimately decided 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 micro-economic policies of the state is to be stressed, since the recession appearing in the postsocialist economy can not be overcome without the state's active interference with that process. This is witnessed, among other things, by the experience of the 1990-1992 period.

Recession in postsocialist countries is a fact. The scale of that recession is so spectacular that there often is talk about the collapse of the economy. The fall in output was very significant so that even in its optimistic forecast version for the future the World Bank assumed the output level from before that collapse would not be attained earlier than in 1996 for the so-called northern part of the region (Czecho-Slovakia, Hungary, Poland) and in 2000 for its so-called southern part (Bulgaria, Romania and Yugoslavia) (Transformation, 1991). On the other hand, there are opinions denying both the magnitudre of the recession itself and its importance.

One can notice that assessments of this type are put forward the more intensively the more long-lasting the recession turns out 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, in suggesting the "sold output" category was inadequate (Rostowski, 1990). Later the compensating effect of the second economy on the global production level was accentuated. At the beginning, and – more precisely – when a prompt appearance of positive trends in the real sphere was still expected, small significance of the parallel sector (not registered by official statistics) was stressed. The International Monetary Fund rightly stressed 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" (World, 1991, p.27). Even on assumption that at the starting-point

Table 4

Unemployment in Central and Eastern European countries

	1990				1991			
	in thousands of persons	in percent of labour force	I half-year		III quarter		year	
			thousands	percents	thousands	percents	thousands	percents
Poland	1126	6.1	1574	8.4	1997	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[a]
former GDR	–	–	1060[b]	12.1[b]	1030	11.7	1040	11.8
Romania	–	1.5[c]	260[b]	2.2[b]	261	3.3	400-500	4-5
Hungary	79,5	ca.2	186	3.9	298	6.6	406	ca 8
CIS	–	–	–	–	ca 1000	1.5	ca 1000	1.5
Yugoslawia	1300	17.0	1500	19.4	1540	20.1	1500	20.1

[a] end of November 1991
[b] August 1991
[c] September

Source: Sytuacja (1992).

it was twice as large as shown by official statistics and was growing twice as rapidly as stated in those statistics – this anyhow would not qualitatively change the picture. Evidently, in Hungary's and Poland's case the private sector already played a not trifling role at the moment of entry into the systemic transformation phase, but even in those cases the extremely positive development trends in this sector would not be able to compensate for the huge output fall in the public sector. Whereas in other postsocialist economies the private sector was – and remains – so modest that to illustrate it the American "Time" is still obliged to photograph women selling pullovers in the streets of Moscow's centre.

It may be noticed that as long as an insignificant recession was expected, an insignificant role was attributed to the second economy, and once the recession has proved to be both deeper and more prolonged, there has been a shift in emphasis and the size and role of non-registered economy is being excessively exposed (Poland, 1992). There is no doubt that its proportions are considerable, but – by its very nature – unknown and, therefore, some authors can not avoid temptation to paint the reality in more optimistic colours than it really deserves.

So, efforts to belittle thet scale of production decline by means of often far-fetched exertions and dubious methodologcal assumption are still going on. For example, Berg and Sachs (1992) try to suggest a much smaller than in reality fall in GDP in Poland in 1991 (3.8 percent instead of 7-8 percent) and – in addition – to explain it mainly by the output loss resulting from the decline in production previously exported to the Soviet Union. Such an approach is of unambiguously apologetic character, since it is intended to embellish the reality out of political and even ideological reasons. Here, it is the assessment of the hitherto made progress in transformation and its costs that is involved. There are persons and institutions who are interested in exaggerating the favourable results of the transformation and its accompanying processes and – at the same time – in belitteling their costs. In extreme cases they talk about the so-called "perception error" – i.e. the situation is better, but people in postsocialist countries are incapable of perceiving it.

But there also are – what is obvious – persons and institutions who – likewise out of political and ideological reasons – make assessments distorted the other way round. Because the whole process of systemic transformation and the associated real and financial processes are entangled in a huge redistribution both of resources (wealth) and flows (incomes). The whole hitherto existing tissue and structure of political and economic interests have been encroached upon, which can not remain without influence on assessments being put forward. But in that case, such assessments are just of political rather than scientific character.

By the above remarks – made, so to say, in the margin of the main train of considerations – we have already touched one of the key issues, namely the causes of recession and depression accompanying the market-oriented transformation of the postsocialist economy. They are complex. Initially, some one-time phenomena were excesively exposed as alleged sources of the unexpected – for the authors of those assessments – economic collapse. Hence, the exaggerated, in my opinion, importance attributed to disturbances in crude oil deliveries from USSR to the ex-CMEA countries or overestimation of the impact of the Gulf conflict at the turn of 1990 (World, 1991). A little later – in view of a more than originally expected persistent recession and its consequences – very strong emphasis was laid on the dissolution of CMEA[6] and disintegration of USRR. But both the events could happen only once; the Soviet Union only once came into being and only once fell, so the above arguments are subject to rapid erosion. After all, it is difficult to explain the output decline in 1992 in Romania or Albania (nota bene, the latter was for almost thirty years outside CMEA) by the dissolution of CMEA which occured 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 partial recognition of the considerable output decline reflected by official statistics as a real fact, however accompanied by suggestion this has no negative significance but to the contrary. Here, particularly unconventional – or rather odd – is the idea of a kind of overindustrialization of the socialist economy and, hence, the need for its rather drastic deindustrialization at the beginning of the postsocialist era (Berg, Sachs, 1992). And this process has to take place not so much through a more rapid development of the services sphere (broadly understood tertiary sector) as through a deep fall in industrial output and shift of the thus set free resources to the services sector. 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 global product structure.

According to another interpretation – and its equally apologetic context is absolutely clear – the basis from which the output fall was counted had been permanently overestimated in the past, hence the real decline in output allegedly was less than that shown by statistical data. And, on the other hand – since, after all, facts could not be completely negated – where the output had unquestionably fallen, we allegedly had to do with elimination of production which should not have taken place at all because of its unprofitability (Winiecki, 1991).

Here, partly valid – though to a limited extent which, for methodological reasons, is extremely difficult to be precisely determined – is the remark, anyway not new, that a part of the lost product must not necessarily mean a real reduction in national wealth and, particularly, in the standard of living[7]. Two phenomena are involved here.

Firstly, a part of output decline in the postsocialist 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 a control of the aggregated demand that the latter falls below the level which would hypothetically balance the demand and supply flows; since, as a rule, in this phase an inflationary overhang appears (on the eve of the

[6] Most frequently, the dissolution of CMEA is presented as an external shock. Such an approach is not fully justified, since that organization has been dissolved in that and not other way by the free will of the countries concerned (or, rather, their rulling politicians). And the fact that it probably was the worst of possible ways is witnessed, among other things, by the fact that soon afterwards already the problem of regional cooperation arouse once more, which could have been approached in a much more judicious way than it was the case in reality. There were many proposals at that time, unfortunately ignored by the politicians (van Brabant, 1990; Rosati, 1992).

[7] That is still more complicated since, during the transformation, a certain decline in consumption level takes place (i.e. just 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 resultant is negative.

entry into systemic transformation it was biggest in Poland and Russia, and smallest in Czecho-Slovakia and Hungary) and must be neutralized (stocks-balancing operation). That operation requires a larger demand reduction scale than that necessary for closing the inflationary gap only (flow-balancing operation). As a result, the aggregated demand falls to such a degree that because of newly created macroproportions a part of the existing production capacities is not utilized, since their potential product can not be sold in the market because of the existing level of effective demand. The search for a way out of that situation without repeated intensification of inflationary processes is just the quest after an answer to one of the questions about pathways to growth.

Secondly, a part of the output loss results from the elimination of value-substracting production. Here, two different cases are possible. In the first one, the decline in output takes place after withdrawal of subsidies which have supported its hitherto maintained level. If a product was produced only owing to its low price subsidized by the state, while under new conditions after the withdrawal (or reduction) of subsidies its price has been set on a level at which a part of the output (and in certain cases even the whole output) can not find outlets, it is obvious that the 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 to do with a positive allocational effect and the output loss at one place is compensated by the appearance of output (or increase in its hitherto existing level) elsewhere. After all, such is the aim of changes. But the snag is that the desired allocational effect does not come immediately nor automatically, namely in view of the still underdeveloped market allocation mechanisms.

Another case of reduction and elimination of value-substracting 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 in previous conditions were capable of profitable exports, in the new reality face the necessity to reduce their production, since it is not sufficiently competitive and does not any more find outlet abroad. Because, previously, such enterprises produced – as measured at world prices – a negative value added. Owing to considerable subsidies, especially to the prices of energy and many raw materials, which was rather typical of the planned economy, the enterprises consumed those inputs to produce goods which were sold abroad at prices lower than those which their producers would have been able to get if they directly sold at world prices the raw materials they had consumed in that production (McKinnon, 1991; Akerlof, Rose, Yellin, Hessinus, 1991). So, it is understandable that with simultaneous far-reaching liberalization of prices and trade, in some cases the hitherto profitable production had to be abandoned. But, on macroeconomic scale, this process brings rather gains than losses in the long run. However in the short run the latter, too, can not be avoided.

So, I have identified four groups of recession sources in the postsocialist economy. They are: firstly, the systemic and structural legacy of the economy of real socialism which was gradually loosing its momentum till the appearance of stagflation trends in its decline 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 have anyway been entangled in recession, although its nature and – above all – depth and duration would have been considerably milder.

Secondly, external shocks of which some were of specific character, since they were not exogeneous in the full sense of the word but – at least partly – self-imposed by political decisions.

Thirdly, effects of getting out from the shortage economy in conditions of postsocialist macroeconomic stabilization. In principle, every stabilization entails a temporary decline in economic activity (Bruno, DiTella, Dornbusch, Fischer, 1989) because of suppression of the demand flow. It was the more unavoidable during a stabilization orientated not only towards reduction in price inflation rate but also towards the removal of shortages and introduction of market-clearing price system.

Fourthly, elimination of the value-subtracting production as a result of reduction and withdrawal of subsidies to unprofitable production as well as through trade liberalization and opening-up of the economy to external competition.

But there also is a fifth cause – in my opinion the most important one – which in some countries is the most momentuous factor contributing to recession and depression in the postsocialist 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, 1992a). If assessments can be shared that countries having good economic policy develop twice as rapidly (Development, 1992), one can venture the opinion that countries with wrong economic policy plunge into recession twice as deep as really unavoidable and stick in that depression longer than necessary.

Effects of a wrong policy in this regard can not be removed any more. But correct conclusions can and should be drawn from the past experience and, basing on them, answers to questions about determinants of growth in the postsocialist economy must be sought.

2. Expectations and reality

There is a strikingly large gap between expectations as to the character and dynamics of real processes during systemic transformation and the reality. According to most frequent expectations there had to be – on the one hand – a shallow and short-lasting recession, and – on the other hand – a quick entry into a dynamic growth phase. Such an error was committed as well by diverse institutions – such as World Bank and International Monetary Fund – as by many individual researchers and experts. In all such cases one can talk about the errors of cutting-down the perspective and of excessive optimism. Where did it stem from?

The causes are complex this time, too. However, in my opinion, at least five groups of them can be distinquished. The first one pertains to the excessive official optimism of the new elites and their governmental bureaucracy. It was the governments (and parliaments, as well) who drew up often absurd plans and forecasts dominated by wishful thinking and lacking a sufficient dose of realism. Insufficient professionalism, lack of imagination and responsibility – all that together contributed to formulation of unattainable goals, like e.g. the assumption of a mere 3.1 percent decline in national product and 5 percent reduction in industrial output in Poland for 1990, or expectations of entry into the recovery phase as early at the end of 1992 in Russia. As may be supposed, politicians in those countries often knowingly proclaimed quantitative objectives about the attainment of which they were at least in doubt. That was dictated by tactical reasons and political strategy. It was to a certain extent understandable but nonetheless hardly justifiable. While it may be understandable that the government of a given country – even if it could have foreseen it* – it is not willing nor even able to declare that its policy will within two years lead to a GNP decline by 20 percent with a 40 percent scale of reduction in industrial output and emergence of more than 10 percent unemployment; since the announcement of such economic programs would entail the overthrow of governments still before they have had time to merit it.

The second group of causes underlying the erroneous forecasts and unrealistic expectations results from an incorrect identification and diagnosis of the realities of postsocialist economy. To-day this state of affairs is incomparably better explored, described and identified than two or three years ago. But, then, the estimates concerning the future were based on preconceived notions and conventional assump-

* In some cases, preconditions for that existed. In Poland, there were prewarnings against the possibility of such collapse which more or less materialized later (Kolodko, 1991a; Laski, 1990), but those warnings were ignored and, later, the government circles rather exclusively talked about forecast errors rather than about policy error which in reality was the case here.

tions rather than on solid analyses and diagnoses. Here, worth mentioning are in particular simplifications such as comparing the state of affairs in postsocialist Central and Eastern Europe with that of postwar Western Europe (Transition, 1991; Wolf, 1992) and – against that background – expectations of rapid growth based on apparent analogy with the reconstruction from previous period's devastations. Echoes of such approach, though weaker and weaker, still persist, especially in some Western circles.

However, greater weight is to be attributed to the approach which treats the postsocialist 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 the Central and Eastern Europe, the majority of whom was entering this part of the continent for the first time in their lives. And, while it might be understandable that in official documents of international financial organizations this group of countries has passed from the dwindling "planned economies" head to the head "European developing countries" (since, after all, not developed ones), doubts or even objections must be aroused by the fact of treating those countries as not much differing by their socioeconomic characteristics from 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 postsocialistic world results from quantitative differences only with respect to price distortions and underdevelopment of market institutions, in particular the financial ones.

But, in reality, we have to do with fundamental qualitative differences. They, first of all, consist in a quite different property structure, while the fact must be stressed that the problem of a 50 percent reduction in the share of the state property where that share is to be reduced from the initial 100 percent level (which has been the departure-point in the majority of postsocialist countries) is quite different from the situation where a similar 50 percent reduction is to be carried out but from an initial 60 to 30 percent level. Because in the latter case, there existed, at the starting-point already, an institutional market-type infrastructure, even it insufficiently developed. A different set of problems is to be solved by the society which attains – by way of example – a 16 percent unemployment level within two years having started from zero than where the unemployment reaches the same rate after doubling from 8 percent 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 big enterprises which employed thousands of people and in this regard, indeed, Russia always outpaced the United States, Poland outpaced Germany, and Czecho-Slovakia – Austria. That, however, represents qualitatively different challenges as to the restructuring of production capacities and its implications than it was the case in Western Europe and Japan in the postwar period (Kiyono, 1992) or, contemporaneously, in South America.

Many more quantitative differences might be pointed out, but it is not necessary here[9]. It is only to be stressed that the postsocialist economy has its separate quality which must be understood first, and only then economic policies aimed at its improvement can be formulated. Since, otherwise – and such a process is advanced already – we will have to do with the so-called latinization of the postsocialist economies (Kolodko, 1990b) and the above-mentioned differences between the postsocialist countries and the LDCs will actually become less and less, which however will not help diminish the problems to be solved. In sum, 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 the rapid and far-reaching economic liberalization[10].

The third cause of false expectations and unfulfilled forecasts steems from their methodological and real faultiness. Since, many forecasts – especially the econometric ones – were based on dubious and often hardly justifiable assumptions. For example, Borensztein and Montiel (1991) accepted – basing on regression analysis – that as much as about 75 percent of investment in the planned economy had been ineffective. The unreality of such an assumption seems as obvious as it is obvious that with the same investment level in conditions of market allocation a higher effectiveness would have been achieved[11]. But the scale of this difference is difficult – if at all possible – to estimate (Kolodko, 1991b). However, the train of reasoning is correct here. The more waste there was in the past (Flemming, 1992, accepts it amounted to 25 percent), the quicker the growth which is to be expected in future. While the error lies in the incomplete understanding and appreciation of conditions on the meeting of which the actual release of the efficiency-oriented growth factors depends. They are so many that the transition to growth phase turns out much more long-lasting than it is often assumed. That growth comes neither quick nor – all the more – automatically. Elimination of inefficiencies typical of the centrally planned economy does not completely remove inefficiencies but merely changes their character during systemic

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[9] Sometime, those differences manifest themselves in a rather unexpected way. In developing countries the ratio of salaries of the ruling bureaucracy elites to global product per head makes even 130:1, e.g. in Nigeria (in USA 8:1 - Abernathy, 1988), which contributes to the passage of well-educated personnel from the private sector to the state administration. In postsocialist economies the situation is quite opposite. Income proportions are such that the developing private sector simply sucks the professionals from the government sector, with all the adverse implications of this fact for the functioning effectiveness of the social services sector and, in the longer run, for the economic growth, as well. On the other handm, this may bolster the development of the private sector and favourably influence the economic growth. The short-term resultant of those countertrends can hardly be assessed.

[10] I think such a point of view is dominant in the Western economic thought with respect to growth prospects following every stabilization (Dornbusch, 1991), though also meeting with justified criticism (Pegatienan, 1991) which points to the specificity of political institutional and structural environments which sometime require a different course of action.

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

transformation. It is only in a further perspective that they can be radically reduced, and – again – this perspective must not be cut-down. It has however been cut down, among other things, out of naive assumptions as to the possibility of rapid privatization of the postsocialist economies and the dynamizing impact of such a property transformation on the real sphere. Neither in the former case (pace of privatization) nor in the latter (scope of privatization) those assumptions have been fulfilled. Recently, however, more scepticism or maybe rationalism regarding the expectations in that sphere can be noticed[12].

As to the fourth cause of excessive optimism no long comment is needed. Namely, it is the often naive hope of the scale of foreign (i.e. Western) economic aid and its salutary, stimulating impact on the production in postsocialist economies which is meant here. Curiously enough, this naive belief consisted not so much in groundless expectations 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 the effectiveness of that support (Palmer, 1992). In many papers, the fact is pointed to that till mid-1992 the scale of Western aid to European postsocialist countries (except the former Soviet Union)[14] has already (in comparable terms) exceeded the aid granted by the United States to Western Europe under the Marshall Plan after the World War II (Eichengreen, Uzan, 1992; Summers, 1992). However, its effects still are very poor and this fact can hardly be explained without getting insight into the mechanisms of distribution and allocation of the inflowing capital and the policy pursued in that regard by the states concerned.

And, finally, the fifth group of causes of false forecasts. They are of remarkably subjectiv character and make a purposeful manipulation of public opinion in order to mislead it. And that opinion is shaky, unsteady and sometimes rather credulous. At the same time, an economic charlatanry is rampant which presents utterly unrealistic visions of the future, also with respect to development prospects. It is difficult to otherwise qualify the promise of one-digit inflation rate one month after the introduction of the stabilization package or assurance of economic growth after half-a-year only. Such visions fall on a breeding-ground and shape the expectations which can not be fulfilled. Motives underlaying those sometimes outright lies are manifold, but most frequently they are of political and ideological character. This might be understandable, but the snag is that this kind of demagoguery is not without influence on actual political choices, too. Thus, it is not simply a matter of charlatans, but of the tribes that

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[12] The Economist, for example, reminds that "...even if the sell-off succeeds, its benefits will not be visible for months, perhaps years. Unmistakably, the first results of mass privatisation will be bankruptcies, closed factories and lost jobs" (Economist, May 16th, 1992, p.13). That is a correct, though in those columns quite new and very tardy view, since earlier it was suggested rapid privatization was a panacea which would almost immediately produce economic advantages, including output growth as well.

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

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

are to be healed by means of their artifices. And that makes the problem very serious, indeed.

That is how the causes of excessively optimistic expectations of growth in the postsocialist economy can be characterized. But it must be remembered that some expectations were justified. In particular, better effects of certain institutional changes (e.g. those relating to deregulation and competition-promoting policy as well as to the general liberalization and financial reforms) and efficiency-oriented effects of macroeconomic stabilization could and should have been expected. Deception which took place in that field was a result of the improper sequencing of institutional changes, on the one hand, and the overshooting of the stabilization policy (at least in some countries of the region) – on the other hand (Kolodko, 1992a; Nuti, 1992; Poznanski, 1992).

So, in conditions of an economic policy to a lesser degree encumbered with errors, better results could have been achieved than it actually was the case. I think that it is in that perspective that the forecasts of the International Monetary Fund formulated in agreement with the concerned governments in spring 1991 should be viewed, irrespective of the fact that they, too, were to a certain extent fraught with some of the above-discussed distorsions (especially with their second and third group). Chosen macroeconomic indicators in this regard are illustrated in table 5.

Table 5

Eastern Europe and the USSR: macroeconomic indicators, 1988-96
(Annual percentage change, unless stated otherwise)

	1988	1989	1990	1991	1992	1993–1996
Eastern Europe[a] 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	16.2	–
– Fiscal balance[b]	−8.0	−6.7	−6.5	−4.2	–	–
Eastern Europe[a]						
– 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[b]	−0.2	−0.1	−1.8	−0.6	–	–
Current account balance[c,d]	6.7	3.0	−1.3	−10.0	−11.2	–
of which: Convertible currency	2.7	0.7	−2.8	–	–	–
Debt service ratio[d] (in % of exports)	19.2	18.5	14.9	18.5	16.8	–
of which: Convertible currency	34.7	29.2	18.1	–	–	–
External debt[c,d,e]	97.9	98.4	106.0	110.2	118.3	–

[a] Eastern Europe is defined to include Bulgaria, Czecho-Slovakia, Hungary, Poland, Romania and Yugoslavia.
[b] In percent of nominal GDP.
[c] In billions of US dollars.
[d] Includes nonconvertible currency data that are converted into US dollars at national transferable ruble (TR) US dollar rates.
[e] Excluding liabilities to the Fund.
Source: World (1991), p.28.

In the following period, the International Monetary Fund is formulating more sceptical estimates already, above all with respect to the economic growth rate. A similar toning down of forecasts can also be noticed in the reports of the World Bank, OECD and EEC. Simply, conclusions are being drawn from the gradually gathered experience.

But, earlier, very optimistic anticipations were sometimes put forward. At the time when the International Monetary Fund assumed for 1991 a GDP decline in six Central and Eastern European countries by 1.5 percent only and then, for 1992, a growth by 2.8 percent (table 5), Borensztein and Montiel (1991) have foreseen for Poland and Hungary a growth by 6-7 percent and Czecho-Slovakia by 3.25 percent, and that as yearly average over the 1991-1995 period. Nearly at the same time, the World Bank, using other forecasting techniques (Summers, 1992), also expected a prompt entry into the phase of growth and its dynamization in the latter half of the decade (table 6)

Table 6

Forecast of gross domestic product (GDP) growth (growth rate in percents)

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	yearly average
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
Czecho-Slovakia	-3.5	-9.8	-4.8	1.2	3.4	4.0	4.3	4.9	4.9	4.9	5.0	1.3
Yugoslawia	-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

* Czecho-Slovakia, Poland, Hungary
* Bulgaria, Yugoslawia, Romania

Source: World Bank.

According to those previsions, the GDP had to grow e.g. in Poland by as much as 6 percent in 1992 after a 2 percent growth in 1991. In reality, it fell by almost 8 percent in 1991 and its further decline by about 4 percent is to be expected in 1992. But a still greater scale of error can be adduced, essentially disqualifying both the applied forecasting techniques and the adopted assumptions. Because, how can otherwise be judged the prevision of GDP growth in Poland by nearly 14 percent over the years 1991 and 1992 (Gomulka, 1990) in the situation where it actually has fallen in almost the same proportion over that period?

It is worth while to try an exercise and to have a look at where the materialization of some of the above mentioned development scenarios for postsocialist economies

Table 7

Scenarios of changes in gross national product (GNP) in 1991-2000

	GNP per head in USD in 1990			Hypothetical GNP level per head (in 1990 prices) on assumption of growth dynamics forecasted by the World Bank for 1991-2000									
Country	1	2		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bulgaria	2530		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
Czecho-Slovakia	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	4 706	4 940	5 187	5 447	5 719	6 005	6 305
Romania	1530		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

Explanation: 1 – at national exchange rate (World Bank), 2 - at purchasing power parity (PlanEcon)

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

woluld lead. That is also udeful, since it permits to see in proper perspective the pathway and distance which separate – and will continue to separate 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, 1990c; Summers, 1992). Those differences and hypotherical indicators illustrating the national product levels for six Central and Eastern European countries and – for comparison's sake – some chosen OECD countries are presented in table 7.

Those forecasts are interesting also because they have anticipated for 1991-2000 a much quicker growth rate (non-weighted average) for the so-called northern countries of the region i.e. Czecho-Slovakia, Poland and Hungary (2.2 percent yearly on average) than for the so-called southern countries of the region (Bulgaria, Yugoslavia and Romania) which, at the starting-point already, were 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 the Eastern and Western Europe is assumed – and even suggested – while, on the other hand, a further differentiation of those levels is forecasted even within the group of the European postsocialist countries (table 6 and 7). Unfortunately, the latter prevision seems more realistic. Next, let us take a look at the scatter and variability of certain forecasts, like e.g. those regarding the growth prospects of the Polish economy, illustrated in table 8.

Table 8

Scenarios of national product growth for Poland 1991-2000

Scenario by		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
World Bank[1]	(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	4 706	4 940	5 187	5 447	5 719	6 005	6 306
Stanislaw Gomulka[2]	(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	5 996	6 405	6 841	7 299	7 788
Borensztein and Montiel[3]	(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[4]	(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 percents. Where forecasts are indicated within a certain range, mean value is given.
(B) At 1991 basis amounting to USD 1,630 (converted at national exchange rate).
(C) At 1990 basis amounting to USD 3,910 (converted at buying power parity - BPP).
Source own calculations. Assumed growth rates according to:
[1] as in table 6;
[2] Gomulka, 1990. The forecasts regards the net domestic product (NDP);
[3] Borensztein, Montiel, 1991;
[4] According to stipulations of *The Letter of Intent* of the Polish Government to IMF, April 1991.

There may be doubt whether in 2000 the GNP level foreseen in some forecast versions for Poland 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 draw up forecasts concerning the growth prospects in postsocialist economy, since we are moving here on quicksands, indeed. All the more, it is time to take a closer look at problems relating to the macroeconomic stabilization and its links with processes going on in the real sphere. Since, the latter can not 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 postsocialist 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, questions arise: how is the notion of stabilization to be understood and what are its specific traits in postsocialist economy? (Calvo, Coricelli, 1992; Kolodko, 1992b).

Under a narrower interpretation, stabilization is understood as reducing the inflation down 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. It is here already that the specificity of stabilization in the postsocialist economy distinquishing 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, 1990; Edwards, 1992). In other words, stabilization means the overcoming of the so-called shortageflation syndrome, a structural feature characterizing the reformed planned economies (Kolodko, 1992c).

Under a broader interpretation, stabilization means macroeconomic system characterized by an equilibrium of flows and stocks alike. Dornbusch and Fischer (1990) define stabilization as an economic process rather than 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, in pointing not only to its features such as a severe tax system or competitive exchange rate, but to sound financial markets and deregulation as well (Dornbusch, 1991).

Thus, under the broad interpretation of macroeconomic stabilization, establishment of such political institutional and structural conditions is meant in which not only the market-clearing price mechanism is working – and that at the possibly lowest level of the general price index – but also a possibly 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.

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

However, such a definition of stabilization is not sufficiently operational. First of all, under such an approach, the economic growth is left out; in other words, there is a possibility of stabilization without growth, but growth in a destabilized environment is possible as well. So, one 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 postsocialist economy that we are looking for.

The 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 the obtention of indispensable budget and trade surpluses and an adequate level of labour force utilization. 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 its too low level has an adverse feedback on the other spheres, including the budget condition and political stability.

Thirdly, the rate of price 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, amont other things, in the curbing of inflationary expectations and 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 guide can be derived from the requirements imposed on the EEC countries under the planned monetary union. It is accepted the budget balance should guarantee the reduction of the total public debt to less than 60 percent 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 the need of 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 (e.g. 10 or 25 years). Here, too,

[16] Those deficits also appear after the implementation of the stabilization package already, though not necessarily immediately after. This is particularly evident both in the cause 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 the gradualist fiscal adjustment. It is rather a many years' fiscal disequilibrium period that is to be expected during the initial transformation period (Gotz-Koziarkiewicz, Kolodko, 1992; Fiscal - Tanzi, 1992), while the budget equilibrium state - like in Poland in 1990 or in Czecho-Slovakia 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 USD 64 billion) which makes 69 percent of GDP. In other postsocialist economies it is still less. However the fact of the matter is that the trend towards increase in this debt gets stronger and stronger.

the situation will be measured by the maintenance of a certain relation to the global product.

To be sure, one can stick in a moderate debt for generations. But there have been no positive experiences in this regard, and in the case of postsocialist countries – maybe with the exception of Romania – the necessity of a future absolute debt reduction is evident. Because that debt by itself is a destabilizing factor (table 9).

Table 9

Indebtment of Central and Eastern European countries in convertible currencies

	Gross debt						
	total in USD					per head in USD	
				1991			
	1988	1989	1990	I half of the year	year	1989	1991
Poland	39.2	40.8	48.5	46.0[a]	48.5	1 085	1 269
Bulgaria	8.8	10.7	11.1	11.0	11.2[b]	1 190	1 246[b]
CSFR	7.3	7.9	8.1	8.8	9.5	505	609
Romania	3.1	0.7[d]	1.2[d]	2.1[d]	1.5[c]	30.2[d]	64.5[c]
Hungary	19.6	20.6	21.3	19.7	20.4	1 947	1 974[a]
former USRR	49.4	58.5[d]	62.5[d]	60.0[d]	65.0	203	240[c]
Yugoslavia	.	17.3	16.5	14.5[a]	17.0[b]	729	.

[a] end of May 1991
[b] end of August
[c] end of the III quarter
[d] EEC Secretary's Office estimate
Source: Sytuacja (1992).

Besides, the exchange rate should be stable (which does not mean fixed) (Exchange, 1991). It is, on the one hand, an expression of stability in the previously mentioned areas and, on the other hand, makes the achievement of progress in those areas possible. If, hovever, the above mentioned conditions were met, 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 necessity to introduce a mechanism of market-clearing prices. Since, most frequently – except some extreme situations – that problem has already been solved both in highly developed (OECD) and less developed (LDC) countries. Whereas in all the postsocialist countries which undertake the stabilization effort a final and irreversible removal of shortage has not yet been settled. 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].

Those criteria can be presented in a synthetic way[19] basing on the "macroeconomic stabilization pentagon" (MSP) model. Its vertices are made of appropriately scaled parameters of the five above-mentioned criteria. Here, we assume that shortage does not exist, i.e.

$$SH = 0 \qquad /1/$$

But if it is otherwise – and this still happens e.g. in some post-Soviet economies or in the so-called southern zone of the European postsocialist countries – instead of the inflation rate the rate of the so-called shortageflation should be represented on the appropriate pentagon axis, even if its exact calculation poses many methodological problems (Nuti, 1986; Kolodko, McMahon, 1987).

With respect to price inflation, mostly measured by the consumer price index (CPI) – although in some cases the use of GDP deflator would be more justified, in particular because the latter category is also used in the present analysis – the logarithmic scale has been used. This has been done not only out of presentational reasons (the inflation rate variability during the period in question ranges from 10 to nearly 600 percent) but also on assumption that progress achieved by a reduction in inflation rate e.g. from 600 percent to 60 percent is commensurate with its reduction from 60 percent to 6 percent, since in both cases the reduction in inflation rate is tenfold.

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

The vertices of the macroeconomic stabilization pentagon (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 is e.g. 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 downwards to zero (as in the case of the unemployment rate or inflation rate)[20]. In spite of the obvious non-additiveness of those five criteria, the interpretation of informations comprised in the pentagon is nevertheless transparent: the larger the MSP area, the better the state of affairs in the field of macroeconomic stabilization. Such a pentagon, approximating the desired ideal, is presented in figure 1.

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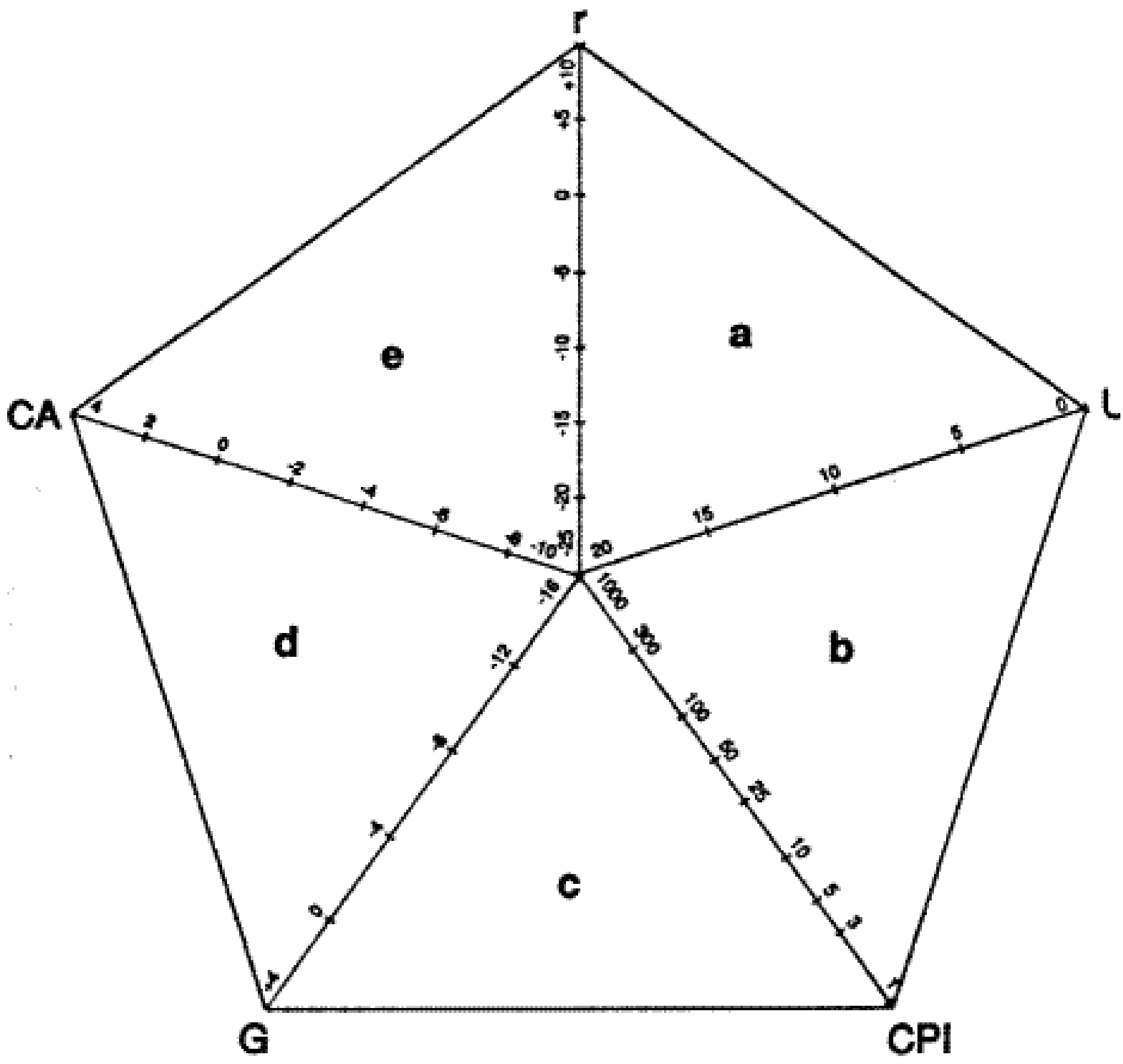
[18] In 1991, the public debt level was higher than in Poland in countries such as Italy (103.8% of GDP), Belgium (131.5%) or Ireland (113.1%). On the contrary, that debt was lower in Japan (63.4%), USA (58.5%), Federal Republic of Germany (43.9%), United Kingdom (36.7%), Spain (45.3%) and Finland (18.6%). (Sytuacja, 1992, p. 28).

[19] Attempts at such a sunthetic comparison of the economic situation have already been undertaken - in other context - i.a. with regard to the research on business cycle fluctuations (Marczewski, Zagozdzinska, 1990) or long term economic trends (Economy, 1991).

[20] I assume that the apperance of disinflation and declinne in overall price level is not realistic in any postsocialist 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 such one which essentially corresponds with the economically justified natural rate of unemployment.

Figure 1

Macroeconomic stabilization pentagon



Note:

$$r = \left(\frac{\Delta\,GDP}{GDP}\right) \times 100\%$$

U = unemployment rate in percents of labour force
CPI = inflation rate (consumer price index)
G = ratio of budget balance to GDP in percents
CA = ratio of current account balance to GDP in percents

Source: Autor's own estimation.

That pentagon consists of five triangles. The area of the first one – triangle "a" which can be called "real sphere triangle" – is delimited by appropriate parameters expressing the rate of changes in real product and unemployment. The area of triangle "b" which can be defined as "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 "budget and inflation triangle" – depends on the dynamics of inflation and state budget balance. The size of the fourth triangle – triangle "d" which can be defined as "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 MSP area signifies an improvement in the economic situation and, to the contrary, its diminishment informs about a deterioration in the condition of the economy. So, from the formal point of view, it is better when, e.g., the area "a" (real sphere triangle) is growing to a larger degree than the area "d" (financial equilibrium triangle) is diminishing. However, a certain conventionality of that approach must be kept in mind. Since, the situation where:

$$MSP = a + b + c + d + e = 1 \qquad /2/$$

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

$$a > b > c > d > e \qquad /3/$$

is not identical with situation described by the inverse sequence, i.e. such in which:

$$a < b < c < d < e \qquad /4/$$

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 scale of decline in output falls or its absolute level grows more rapidly, and whenever the unemployment rate falls. Changes in that latter rate automatically entail changes in the size of the stagflation triangle (b) whose shape is dependent on the inflation rate, as well. The latter, in turn – together with the ratio of budget balance to GDP – 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. Finally, the latter, together with the index of real sphere dynamics which has been our departure point, determines the size of the external sector triangle (e).

Unfortunately, the reality of the postsocialist economy is much more complex and less favourable than that represented by the hypothetical macroeconomic stabilization pentagon shown in figure 1. In figures 2-6, the actual state of affairs in five European postsocialist countries is shown against the background of the above configuration symbolizing the near-optimum state[21].

Of course, the notion of stability – like its antinomy – is relative. Still, we can always talk either about an ongoing stabilization processes or about destabilization. Making use of the above-proposed methodology, the trends manifesting themselves in this regard are determined by the time variability of the shape and – keeping 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:

$$k = 1/2 \sin 72° \qquad /6/$$

So, 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 practically does not permit to formulate any conclusions of generalizing quality. Because of lack of adequate data it is difficult to draw appropriate pentagons e.g. for quarterly series, which already could facilitate the observation of possible tendencies. But even on the basis of that modest amount of information it is evident that progress in stabilization has been small and even controversial. For example in the case of the Polish economy (figure 5) – provided the first quarter of 1990 is separately treated because of its specificity 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 postsocialist countries, while the situation is relatively most favourable in Czecho-Slovakia (figure 3) and Hungary (figure 4). It is to be added that in some other postsocialist economies, especially in the post-Soviet states, a further destabilization is still going on. Unfortunately, the lack of indispensable data precludes its illustration by means of the MSP technique which has been used here.

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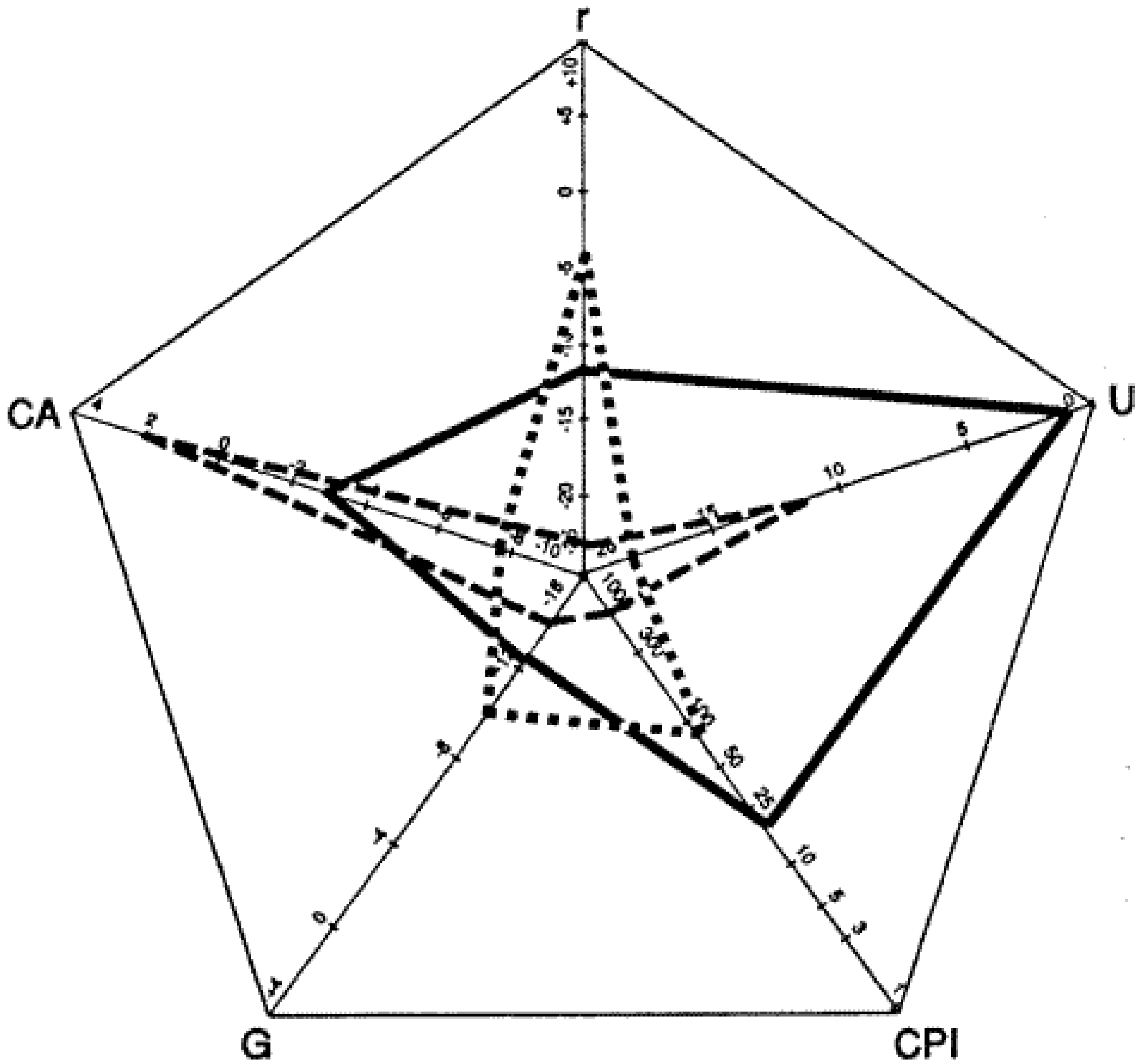
[21] The sources of informations being presented are not uniform. For Bulgaria and Romania, those mainly sare IMF data, while with respect to inflation estimates for Romania, point-to-point indicators have been calculated basing on informations obtained from PlanEcon (Romanian, 1992). For Poland, data come from the Central Statistical Office. In the case of Czecho-Slovakia, informations were obtained fgrom the Ministry of Economy, while for Hungary - from the Economic Research Institute in Budapest. Some indicators, especially those comprising 1991, are estimates. Many of them arouse serious methodological doubts (Berg, 1992), hence they not always are fully reliable. But, at present, I have no better information at my disposal. As to the forecasts for 1992, in most cases they come from the same sources at the statistical data being used here. Wherever, the forecasts have been given within a certain range, arithmetical mean has been useed. For those reasons, the results which are presented here must be treated with indispensable caution, since they will require verification in future.

[22] The snag is that the policy-induced rise in prices by more than 140 percent in the first quarter od 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 yearly scale the CPI amounted to about 250 percent, its level, excluding the first quarter, amounted (in yearly scale) to 72 percent only. And from that level there practically was no further reduction during 1991 when the inflation amounted to over 70 percent as well. Also, in 1992 the situation has not significantly improved.

Figure 2

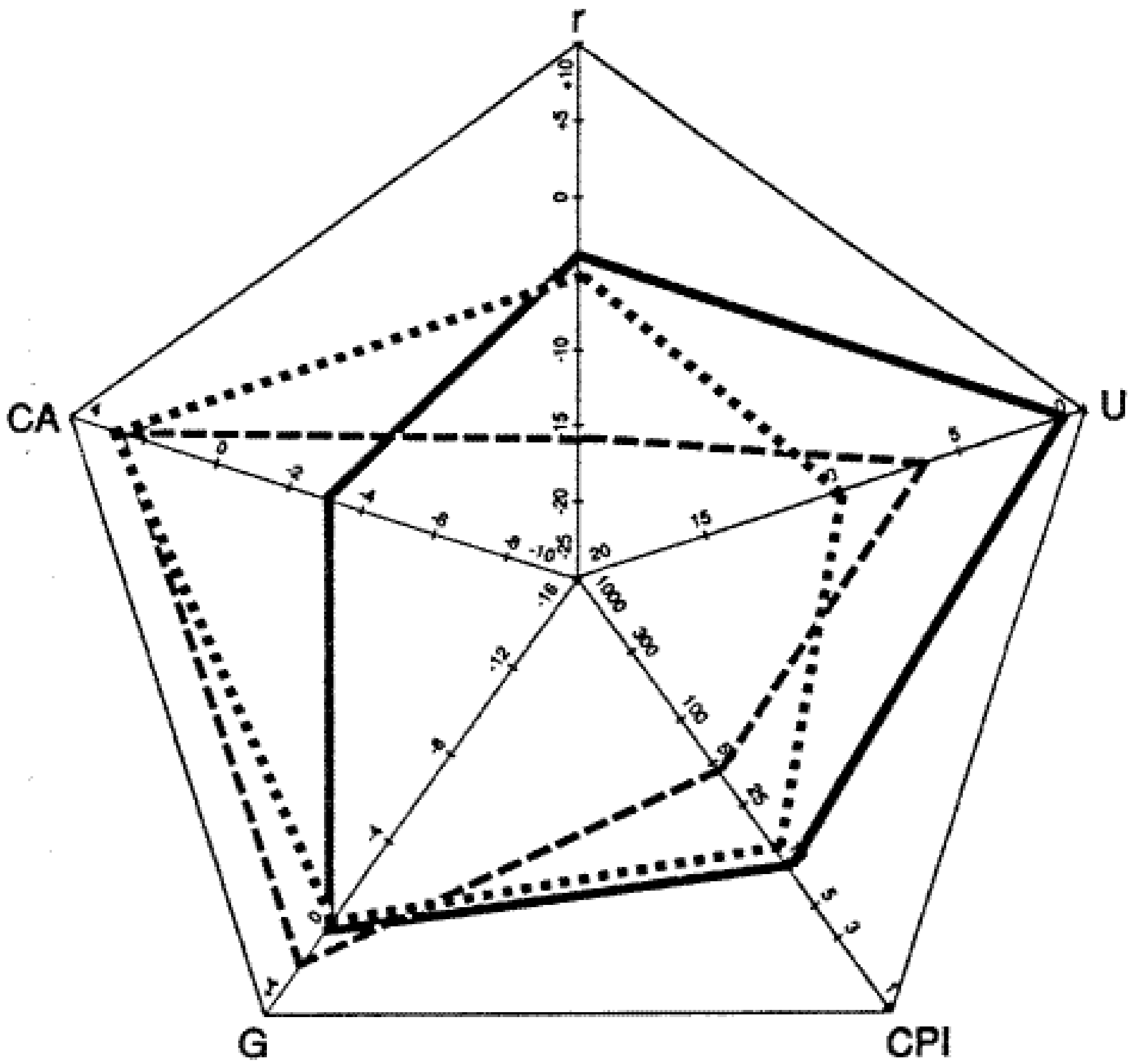
Macroeconomic stabilization pentagon
Bulgaria 1990–1992



	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

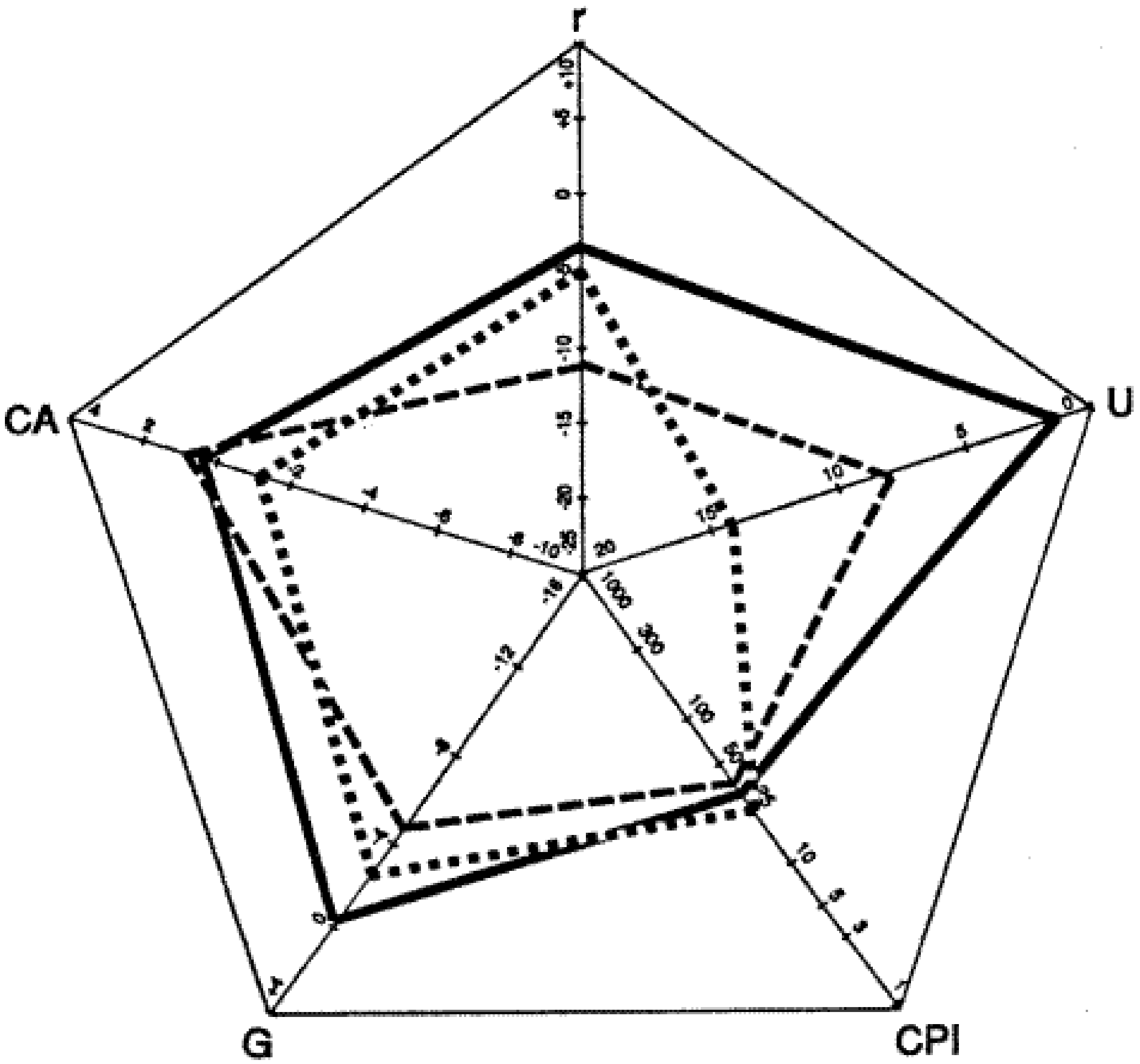
Macroeconomic stabilization pentagon
Czecho-Slovakia 1990 – 1992



	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

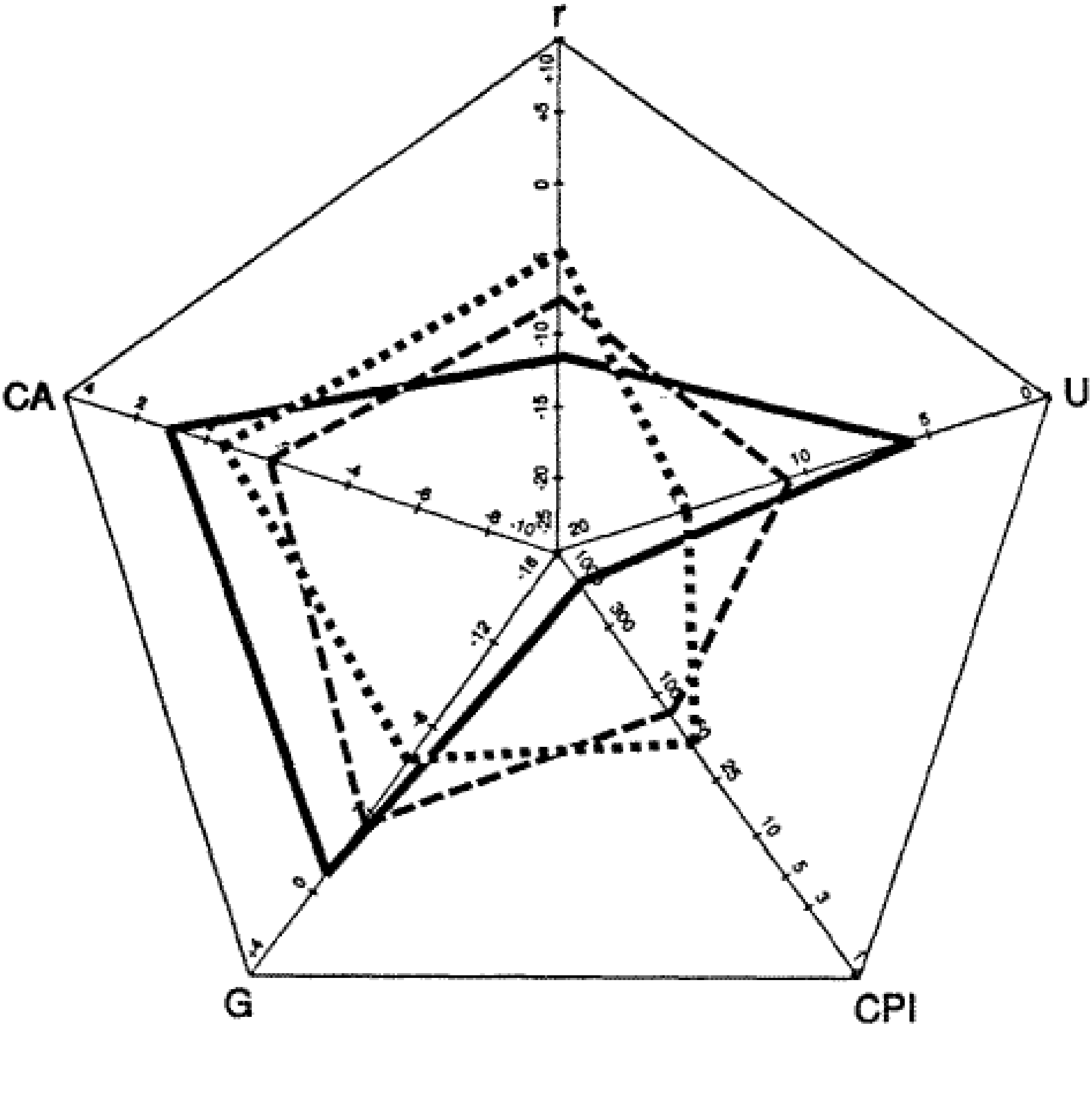
Macroeconomic stabilization pentagon
Hungary 1990 – 1992



	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

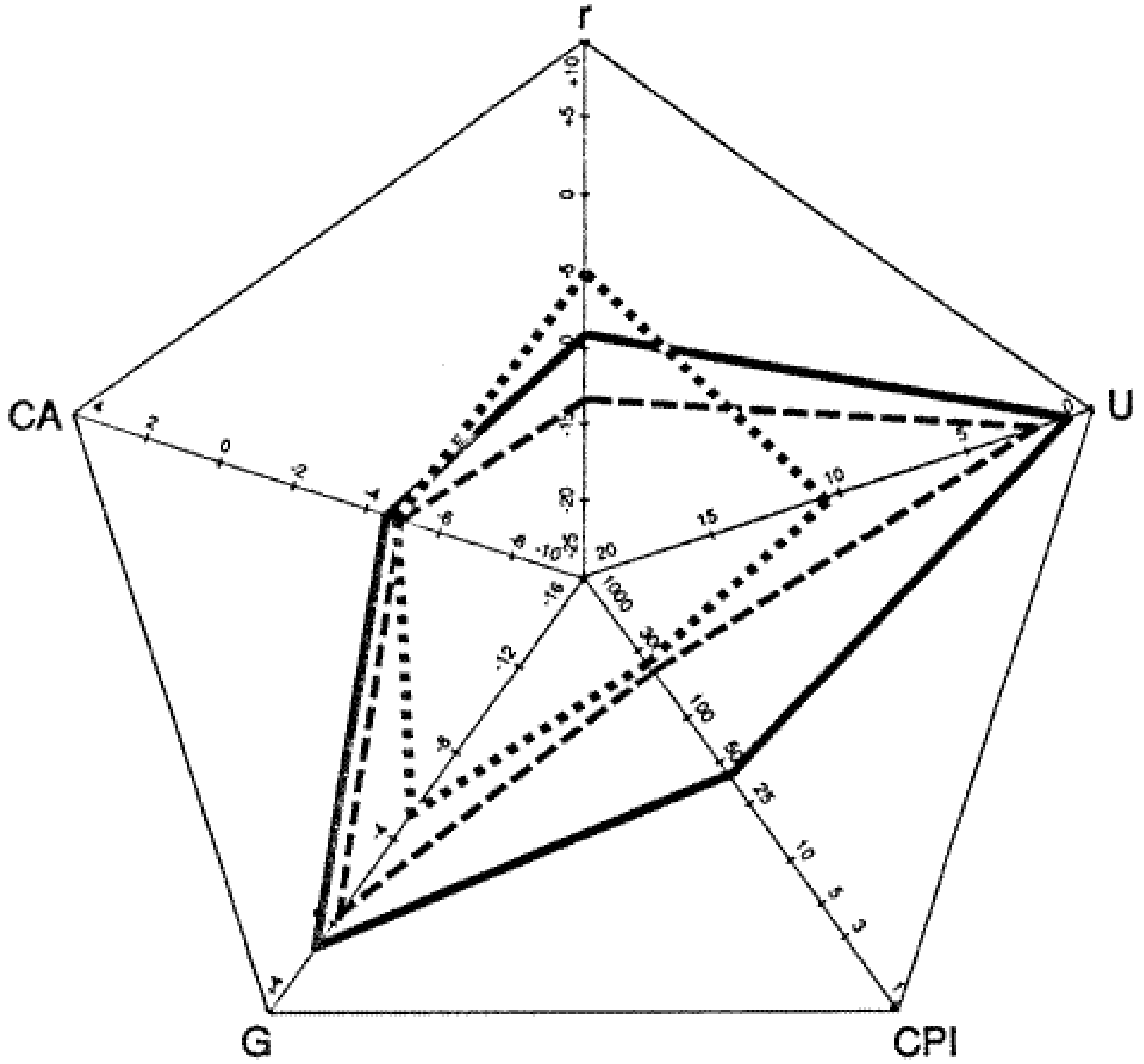
Macroeconomic stabilization pentagon
Poland 1990–1992



	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
Romania 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

Thus, an attempt can be made at a quantitative measuring of the progress in broadly understood stabilization (or of its lack). Here, the reference point is the size of the standard macroeconomic stabilization pentagon (figure 1). On 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 thus calculated coefficients – for distinction's sake I will call them msp – and the coefficients of the a, b, c, d and e triangles which make their components, are presented in table 10.

Certain feedbacks take place among the processes reflected in information carried by the vertices of the macroeconomic stabilization pentagon. In particular, the economic growth is influenced by the remaining phenomena and processes analysed in the above context. A strengthening of that influence is desirable, among other things, that the economic growth process being thus initiated and intensified might assume some definite characteristics. A great and, in conditions of postsocialist economies under transformation, very important influence on the character of that growth is always exerted by the economic policy. So, it is worth while to take a somewhat closer look at its determinants and implications.

Table 10

MSP macroeconomic stabilization coefficients in 1990 -1992

Country	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
	psm	0.255	0.032	0.073
Czecho-Slovakia	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
	psm	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
	psm	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
	psm	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
	psm	0.365	0.217	0.176

Source: Author's own calculation.

4. Economic policy

The scope of the influence of the state's economic policy has always been subject to theoretical and political debates. Those debates especially intensify in critical periods, and to such periods undoubtedly belongs the market-oriented systemic transformation of the postsocialist economy. With a certain dose of simplification, it may be accepted that the main axis of controversy in debates on systemic transformation is – on the one hand – the controversy about the degree of shock therapy versus gradualism in the transformation of the economy, its institutions and structure and – on the other hand – it is a controversy about the state's role in those processes (Transition, 1991; Drogi – Dymarski, Wilczynski – 1992; Lipowski, Kulig, 1992).

It seems that the neoliberal – sometimes extreme – approach which prevailed in the initial phase of the debate is slowly receding in view of the experiences arising from the transformation process itself. That is in particular evident against the background of the discredit of the sometimes professed conception of the so-called constructive destruction according to which the transition to the economic growth phase essentially has to come about automatically, without the need of any state interference, upon clearing the economic structure of the inefficient units through their massive and quick bankruptcy. The thus set free assets would find – on the strength of market mechanism introduced in a shock way – a more efficient employment than before, which would put the economy on the pathway of growth. With such an approach, the role of the state is rather limited. It has – on the one hand – to foster the thus interpreted destruction, and – on the other hand – to assist the establishment of the market infrastructure. The rest should be done by the market itself and its forces.

To a certain extent such an approach has been applied in some postsocialist countries, most fully in Poland, but also in Czecho-Slowakia and, partially, in Russia; whereas in East Germany in its former part only, since the state's role in the economic restructuring of the ex-GDR has been significant. The effects of such a policy are not encouraging, hence a certain change in the theoretical orientation, but also a somewhat different approach of the international financial and economic organizations and the West to their role in supporting the transformation. That approach has been since a certain time characterized by a greater pragmatism (Transformation, 1991; Transition, 1991; Preventing, 1992).

The economic policy is heterogeneous, hence it can be classified according to many criteria. They should be each time subordinated to the object of analysis. Therefore, from the here relevant point of view – i.e. the role of the economic policy in stimulating the macroeconomic stabilization and growth in the postsocialist economy under transformation – four currents of that policy are worth distinguishing. The first one regards the macroeconomic stabilization, the second one – the sector of service infrastructure for the production sphere, the third one covers the state's direct production activity, and the fourth one regards the tools of interference in the productive activity of the private sector (Krueger, 1992).

As to the macroeconomic stabilization policy, it comprises five basic aspects. Fiscal adjustment aims at a sustained balance of the public finance system, along with its simultaneous market-orientation reform. In particular, in the postsocialist economy a radical reduction in subsidies to unprofitable production and prices as well as a change in the structure of budgetary revenues towards a heavier burdening of the consumption sphere is meant here. It is also necessary to restructure the sphere of social insurances so that they should not make an excessive burden on the state budget nor lead to chronical fiscal deficits.

The second aspect is price liberalization and price adjustments. Here, it is intended to create conditions conducive to the working of the market-clearing price mechanism through subjection of price formation to the market forces. In justified cases – as a rule, temporarily – centrally administered price adjustments also take place. In particular, they concern the energy prices because of their great importance in the formation of production costs, as well as prices of some services, especially those min the housing sector which strongly influence the cost of living and, consequently, the cost of labour and the general level of inflation stimulated by cost factors.

The third aspect of the stabilization policy regards the monetary restrictions which have to prevent the corrective inflation (hyperinflation) induced by measures taken in the fiscal and price spheres (as well as in the exchange rate sphere because of the significant scope of devaluation carried out on that occasion) from degenerating into a chronic inflationary process. This requires a rigorous control over the pace of changes in money supply to the economy in order to prevent an excessive scale of liquidity, but in a way which will not lead to excessive contraction in the real sphere.

The unusual vehemence of adjustment processes in the strongly destabilized postsocialist economies in the initial phase of transformation – in spite of the general course towards an orthodox policy fostering the economic liberalization – requires certain heterodox measures (Kolodko, Gotz-Kozierkiewicz, Skrzeszewska-Paczek, 1992), including the wage control. The adjustment of wages to new price conditions must be, out of balance reasons, strictly controlled. It is indispensable least the compensational rise in wages (and other incomes linked to wages, in the first place such as old-age and disability pensions) neutralize the favourable effects achieved owing to other measures taken in such spheres as price adjustments and competitive exchange rate.

It is just that exchange rate which is the object of the last – fifth – aspect of the macroeconomic stabilization. In particular, the problem consists in the introduction of convertibility of the domestic currency and its stabilization on a real level which will secure the attainment of goals related to the current account balance.

The macroeconomic stabilization policy – as interpreted in the present paper – must also mean actions aimed at the maintenance of a certain level of economic activity. Hence, its principal trends must be perceived in the context of the previously presented macroeconomic stabilization pentagon; since, otherwise, it may be overshot and measures serving the achievement of the desired objectives can transform themselves into autonomous objectives[23].

As we remember, the transformation process comprises three components. The first one is just the macroeconomic stabilization which is to be attained by means of the above-mentioned current of the stabilization policy. And as to the remaining kinds of economic policies mentioned earlier, their field of action includes both – the second and third components, i.e. – the institutional changes and the microeconomic restructuring of production capacities. From that point of view, the importance of a policy orientated towards securing the functioning of the service infrastructure for the production activity of private economic agents, should be obvious. Here, above all, the setting-up and development of "hard" services such as a network of roads, traffic systems and communications as well as of "soft" services is aimed at. As to the latter kind of services, an efficient functioning of institutions, in the first place the financial ones inclusive of the banking and insurance systems, must be secured. The private sector alone is not able to create conditions which are necessary for its own functioning and development. Here, the state's activity is indispensable in certain fields. Because it is only then that the private enterprise will be able to show its efficiency. For that, an infrastructural policy persued by the state is an indispensable, though certainly still insufficient prerequisite.

The third current of the state's policy whose domaine is – as oppposed to the two preceding ones – rather the microeconomic sphere regards the state's direct production activity. The state as owner of production assets should – as long as it remains their owner – efficiently manage them. The range of the state property is very differentiated. In the postsocialist economy we already find countries (such as Poland) where the state sector produces less than 2/3 of the national product as well as such in which it still gives over 95 percent of the domestic product (Albania and Russia in mid-1992). Similar are the proportions in employment in the respective property sectors.

It is a specific, most distinctive trait of the postsocialist economy distinguishing it from all the other countries – both OECD and LDC – that the state property is still dominant. The question of the pace and direction of change in such a property structure makes a separate problem (Transition, 1991). From the very nature of the market-oriented transformation process the necessity of a far-reaching and possibly rapid privatization arises. However, one can not privatize more and faster than feasible. All the more, the state is obliged to manage with reasonable efficiency the enterprises owned by itself least they be a burden on its budget, but to make them the essential and possibly stable source of its revenues during the transition period; and the latter will not be as short as originally expected. Otherwise, efforts towards balancing the public finance will be doomed to failure and the above-mentioned perverse effect of fiscal adjustment can take place. Thus, a state whose economy is being transformed must not treat its property as insolvent's assets which should be as soon as possible brought to hammer – or simply given away for nothing – but rather as a source of

[23] It seems that was just the case in Poland with regard to the exchange rate whose devaluation scale was remarkably overshot at the starting-point of the implementation of the stabilization package, and later that rate was maintained at a fixed nominal level which led to a recession-generating real appreciation of zloty.

revenue and work-places for a considerable, though decreasing, as a result of progress in privatization, portion of the work-force. So, it is necessary to improve the efficiency in managing the existing production assets, irrespective of their forthcoming privatization (Frydman, Rapaczynski, 1991).

And, finally, the fourth current of the economic policy which comprises a set of incentives – both positive and negative – as well as control measures used by the governments to influence the resource allocation within the private sector. Here, the governments have at their disposal some direct-action tools as well as numerous and more frequently used indirect tools. They assume particular importance in conditions of economic liberalization and deregulation, the latter being, after all, two of the most important features of the transformation processes. So, it is understandable that the importance of indirect-action tools – applied, above all, through the fiscal, monetary (money and foreign exchange) and trade policies – is growing in the postsocialist economies.

The thus defined four currents of the economic policy, implying the macroeconomic stabilization and creating prerequisites of economic growth, have a changing, variable importance in the postsocialist transformation period. First of all, emphasis is shifted from the third current (direct production activity of the state) to the second (creation of an appropriate service infrastructure for private enterprise) and fourth currents (measures stimulating and controlling the private sector's functioning). That corresponds with the dynamic character of the triad: macroeconomic stabilization – institutional changes – microeconomic restructuring of production capacities; since, those processes partly take place simultaneously, and partly must follow each other in a certain sequence (Fischer, Gelb, 1991; Tardos, 1991). In that field, the property relations have particular importance. The more speady the privatization process, the more active the state's policy with respect to those currents must be – and vice versa. It is just the state's policy which implies the success (or rather its lack) in the privatization field.

In other words, the postsocialist state should not so much withdraw from the economic sphere, as rather restructure the character of its interference in it. With respect to the direct production activity, a process of the state's self-containment must take place to enable a better and faster development of the more efficient and competitive private sector. On the other hand, it is just the autonomous development of that sector which enforces the limitation of the state's expansion in the production sphere by getting the upper hand of it through a better utilization of limited resources.

At the same time, as a result of the transition to a market-type regulation of the behaviour of economic agents, the state must change its economic policy methods. This, however, in no way means a lesser, but rather a different role of the state and its economic policy. This does not come about easily, since a change is needed in the public administration's competences, knowledge and habits. And in that field no shock therapy is possible. Those qualities must simply be learned – and experienced – this process being both long-lasting and expensive. In the postsocialist economy still other, additional difficulties appear in this regard resulting from the above-mentioned disproportions in income between the governmental bureaucracy and the thriving private sector.

Relations within the economic policy are very intricated and often not fully realized by the decision-makers and the lobbies which exert pressures on them. Although the mechanism of their functioning is subject to substantial changes in the transformation phase in comparison with centrally planned economy, it still remains not quite transparent. Since, economic policy decisions can be met which – being imposed by certain lobbies – ultimately will not serve their interests in the long run. Numerous time lags which appear between the decision and its full effects are underestimated and sometimes simply overlooked. That is the more dangerous, the stronger the trend is towards cutting-down the time perspective of processes. And it is already known that this is a rather strongly manifesting itself characteristic of societies under transformation, including their political elites.

Here, many instances of the dangers resulting from that for the stabilization policy and growth could be adduced. Let us e.g. notice the implications of the swift growth of the hardly – if at all – controlled internal public debt in the majority of postsocialist countries. And those implications are quite different in the first year than in the tenth one. When in Poland, e.g., a one-stroke increase in public debt by about 5 percent of GDP is intended in 1992, we must take into consideration not only the short-term effect of crowding-out the underinvested private sector from the narrowed credit market, which after all turns against the long-term economic growth, but also the consequences which the swift increase in that debt will produce even in 2002.

In general, there are no economic politicians who reason within such time horizons and in categories of long-term responsibility. And, after all – if we stick to the above example – the contraction of an about 5 billion dollar debt by the state during a single year (od which about 80 percent in the internal market) in the face of the still galloping inflation will have far-reaching consequences for each of the vertices of the macroeconomic stabilization (destabilization) pentagon over the following years. Unfortunately some of those years go beyond the time horizon of the policy and the politicians in whose understanding they also go beyond the horizon of their responsibility. That discordance of time perspective is the greater, the more unstable the political situation. And in almost all postsocialist countries it precisely is unstable, and that without any visible trend towards an explicit turn for the better. That by no means facilitates the progress in efforts towards entry into the economic growth phase.

5. Character and factors of growth

The inflation – or, more broadly, economic destabilization – hampers the growth in various ways. That is witnessed not only by recent experience of Central and Eastern Europe, but also by the thorny road from destabilization to growth in Latin America. From the latter's experience in its strife for economic development (De Gregorio, 1991) at least four conclusions must be drawn for the postsocialist countries, since some elements of their future can be discovered in the recent past of the Latin American economies.

Firstly, one of the most important determinants of growth is the investment, while its composition is not unimportant. In particular, foreign investment has great importance because it is characterized by a higher effectiveness than the domestic investment.

Secondly, in a longer time perspective inflation always has an adverse impact on the economic growth. The scale of that adverse impact depends not only on the absolute inflation level, but also on its time-variability. Here, the imprevisibility of inflationary processes is particularly dangerous (Kolodko, 1987), since it makes appropriate economic calculations extremely difficult to perform. There has been no positive instance of growth in conditions of a protracted, high and variable rate of inflation.

Thirdly, the consumption of the governmental sector adversely affects the economic growth; the greater it is, the worse the prospects of intensyfying the development processes. In spite of the general correctness of the above formulation it is to be remembered that much depends on the structure of expenditures of the governmental sector. However, in the majority of cases – above all because of the significant expenses on the maintenance of the state machinery and support given to the incompetitive state sector – it is just such that it does not help the release of the growth trend.

Fourthly, the level of political stability is positively correlated with the economic growth (Alesina, Drazen, 1989), When comparing the experience of countries having similar problems and institutional and structural conditions, it can be noticed that in cases where the political system is more stable, better results with respect to the pace of changes in output have been achieved.

Curious enough – and rather striking – is the finding that both the degree of the economy's opening-up to external economic contacts and the distribution of incomes do not significantly affect the growth (De Gregorio, 1991). Maybe, it is a Latin American specificity of those processes – given the totality of their context, although a reasonable explanation for such an interpretation can hardly be found. And it is rather to be accepted that both those factors already have had a significant impact and in future will exert a still greater influence on development processes in the postsocialist economies.

From the point of view of our considerations, the most important problem here is the inflation and its destructive impact on real processes; because the inflation contributes to a decline in the propensity for saving and, consequently, to a reduction in accumulation capacities of the national economy. Besides, a galloping inflation not only results from but also – earlier or later – leads to monetization of budget deficits. The monetization of deficits, while acting as a kind of substitute for tax, indirectly leads to a fall in the effectiveness of investment. Moreover, incertitude about the future inflation rate always discourages investment.

But the question of links between the monetization of budget deficits and growth must always be perceived in the context of available alternative (Max Corden, 1991; Kolodko, 1992c). If that alternative consists in the crowding-out of enterprises from the credit market, this also does not foster the growth. And it that alternative means a limitation of the state's investment expansion, it may – in accordance with the structure of investment to be limited (or given up) – either foster the growth as a result of reduction in the inflation rate, or hamper it if, as a result of cuts in state budget expenditures, otherwise indispensable infrastructural investments are not carried out. It often happens that both those consequences of budgetary cuts appear jointly and, then, it is their resultant which can variously work out that counts. Till now, no sufficient empirical evidence is available to estimate this resultant with respect to the postsocialist economy. However, many symptoms suggest that budgetary cuts entail adverse consequences both with respect to short-term developments in the production sphere and to long-term growth trends. At the same time, they do not bring the desired antiinflationary and stabilizing effects because of the appearance of the above-mentioned perverse effect of fiscal adjustment.

As opposed to other experience, in the case of postsocialist economy under transformation, the still existing shortages can make an important factor hampering the passage to the economic growth phase. Not everywhere shortages have been removed, this being a function not only of an incomplete price liberalization in some countries, but also of the lack of adequate institutional surroundings permanently securing the functioning of a market-clearing price mechanism. The shortages lead to falsification of informations coded in prices. In consequence, the allocation – of both capital and labour – is below-optimum and does not assure the best possible use of the available resources. So, when talking about the adverse impact of inflation on the economic growth, one must also keep in mind its repressed form whose vestiges still make themselves felt in the period of market-oriented transition.

Then, the next important question arises, namely: is the achievement of positive effects in the area of antiinflationary measures and macroeconomic stabilization (in its narrower understanding) sufficient for entering the phase of economic growth? The answer is – no: as has been shown, it is a necessary but by no means sufficient condition. There are various reasons for it. First of all, it is stressed that the holders of assets may delay decisions on the repatriation of the previously – in the period of economic and political unheaval – exported capital (Dornbusch, 1991). Such an argument is of huge importance e.g. with respect to Brazil where – according to estimations – the capital sent abroad by that country's citizens (over USD 60 billion in 1979-1987 alone) is not much less than the country's external debt, as well as in the case of Mexico where it was estimated that as much as one third of resources invested from external sources amounting to about USD 16 billion in 1991 in reality was a repatriated capital (Barham, 1992). This would have been more than had fled the country over the whole 1983-1987 period (Cumby, Levich, 1987).

Whereas, in conditions of postsocialist countries, the above phenomenon can not assume a larger scale since, here, no capital flight[24] took place. The only country where such kind of capital can have a relatively greater importance is Yugoslavia and other states emerged from its disintegration. To a much lesser extent that may regard Poland, hovever here the phenomenon has a marginal dimensions only. The problem may still assume a greater importance – and its weight is already growing – because of the only now arising danger of flight of the otherwise very limited – in comparison with the enormous investment needs – capital, i.a. as a result of economic liberalization including the introduction of convertibility. Evidently, that would turn against the growth. Hence, the obvious conclusion that a set of indispensable measures should be taken in order to prevent a possible capital flight or at least minimize its size. Those measures will have a feedback on the whole stabilization policy.

The second point to be stressed in the context in question concerns the danger of delay in the implementation of investment projects, and that even where it seems that positive stabilization effects have already been attained. Here, it is obviously assumed that capitals exist which might be invested. Thus, a certain time lag takes place between the appearance of stabilization harbingers and the investment decisions, since the stabilization must authenticate itself. Economy stabilization is not a state but rather a perspective or trend. It has to manifest itself in a sequence of changes, e.g. assuming the following form:

$$msp_{t_2} > msp_{t_1} > msp_{t_0} \qquad /8/$$

where the subscripts "t" denote consecutive periods. It is only then that the above-mentioned positive trend can be authenticated in the eyes of potential investors and influence their decisions having long-term implications.

A specific trait of the early postsocialist economy is the concentration of the private sector's activity on the services, in particular on trade. That sector is most susceptible to privatization and, moreover, it develops more rapidly than any other economy sector. What is important, it absorbs a considerable portion of the scarce capital, because the production sector can not stand up to competition by trade. So, private investments flow not exactly to those spheres which determine the future growth rate but mainly to areas which – at certain risk – offer a chance of high profitability and quick return. Quite understandably, that is mainly the trade because interest rates on credits are high and in case of investment in industry or even construction, its return time is longer. Thus, while favourably assessing the far-carried liberalization of trade – since it contributes to the stabilization of the economy and its equilibration – one must keep in mind that it is in serious competition with new

[24] Here, I adopt a broad definition of capital flight. Abstention from transfer of capital accumulated abroad to one's own country must also be perceived in this context, in spite of the fact that the above-mentioned capital has been created abroad and has never before in its owner's country.

investment in the production sphere. Therefore, the latter must not be treated in the same way as investment in the sphere of trade services. During the period of transition to a market, industrial and building investments must be supported by means of an appropriate industrial policy, on the one hand, and a trade policy including tariffs and currency policy, on the other hand.

The shortageflation syndrome – so characteristic of the reformed planned economy before its entry into the transformation era – very effectively discouraged the saving. In that period, the bulk of savings was of compulsory character. Conceptions anticipating the transformation of those money resources of the household sector into capital have proved naive. Inaptitude of attempts undertaken in this regard as well as – and above all – the unreliability of the economic policy and the resulting still higher inflationary expectations make such an operation impossible. The excessive liquidity of the household sector has been removed not through the transformation of a portion of its money resources into capital but through inflationary depreciation of those resources. Such a development was prompted by the negative real interest rate on bank deposits, sometimes reaching a very high level. The totality of that state of affairs resulted in disinclination for voluntary savings. Fundamental changes in this regard – and they also have substantial importance for the prospects of economic growth – will be brought about by the transformation to a market economy only.

I think that in the postsocialist economy several consecutive phases can be distinguished in this area. The first one is characterized by the still reserved attitude towards saving. Here, we are talking about reserve only, but it is worth noting that for a large part of households saving is simply not possible because of a very deep fall in the level of their real incomes during the first years of transformation. This phase can be defined as "disinclination for saving" phase.

In the second phase – as a result of the first signs of stabilization or, maybe, only reversal of the trend towards aggravation of economic situation and, in particular, as a result of newly created opportunities – the propensity for saving is growing. The thus emerging capital assumes, in the first place, the form of acting capital. It is the so-called "wild capital" targeted on very speedy circulation and quick profits. The latter, in turn, make the basis of the specific postsocialist primary accumulation of capital. But they also can make the object of transfer abroad, which is to a large extent just the function of progress – or rather its lack – in both economic and political stabilization. That is the "wild capital" phase.

The third phase – and it may be supposed that such economies as Czecho-Slovakia, Hungary or Poland, countries which are most advanced in the market-oriented transformation process, have entered that phase in 1992 – is characterized by a certain procrastination in making strategic investment decisions, because the policy with respect to actual creation of conditions for profitable investment has not yet gained sufficient credibility in the eyes of potential investors. That is related to the above-mentioned deferment of the intended investment projects till the time of better guarantees or lesser degree of the pertinent risk. In that phase attention is focussed on and responses are particularly sensible to the exchange rate variability, interest rate fluctuations and general terms of crediting the economic activity, the state's fiscal policy and its stability (or, rather lack of such stability), trade policy including above all the tariffs and variability of the licensing policy wherever – in spite of a general liberalization – it is still pursued. The more variable those parameters and the more wavering the state's policy in influencing them, the more this phase is protracted, with all the obvious adverse implications of this fact for the economic growth. That phase can be defined as "wait-and-see" phase.

In the fourth phase signs of confidence in the new system already appear, although the credibility of the new policy is still not so good. It is just the immaturity and in many cases simply the incomprehension of the former and the unsteadiness of the latter which cause that investment decisions are still being delayed. That phase can be called "confidence and waiting" phase. Its signs are more and more intensifying in the more advanced postsocialist economies, especially in their northern zone, but those still are mostly precursory signs.

And, finally, the fifth phase – for the time being, except Eastern Germany, prospective only – is the "confidence and investment" phase. However, its materialization requires a significant, qualitative progress in the broadly understood macroeconomic stabilization. The fundamental complication in this field lies in the strong feedback between those processes.

Understandably, those phases can to a certain extent overlap. There also may be a movement in opposite direction i.e. from a later phase back to an earlier one. Finally, the duration of individual phases is very differentiated too, both with respect to particular countries and to individual phases. An attempt at illustrating the situation as appearing in this field in chosen postsocialist economies – keeping in mind the conventionality of such an approach – is presented in table 11.

Table 11

Saving and investment phases in postsocialist economy

Phase / Country	I disinclination for saving	II wild capital	III wait-and-see	IV confidence and waiting	V confidence and investment
Bulgaria	+	+			
Czecho-Slovakia		+	+		
former GDR				+	+
Hungary			+	+	
Poland		+	+		
Romania	+	+			
Russia	+	+			

Source: Author's own estimation.

But even where the economy already is in the fifth phase – the "confidence and investment" phase – this still does not mean economic growth, since the effect delay time must elapse first. In the extreme, best and, at the same time, exceptional – from this point of view – case, namely in the former GDR, the transition to growth can be expected in the latter half of 1992 already. In the remaining cases that perspective may be more remote.

The situation is additionally complicated, because the expectations and behaviours of private and public economic agents are not identical. That is a particular characteristic of the postsocialist economy resulting from the size of the state-owned sector. One might try to apply – separately to each of the two above-mentioned groups of economic agents – the above analysis, especially from the point of view of their approach to investment decisions. Because of the still huge share of state-owned enterprises in the postsocialist economies under transformation, their behaviour here is more important, in spite of the fact that in a very long perspective it is not them but the private enterprises who will determine the economic growth trends. However, till now, it is just the state-owned enterprises' incapability of investment expansion – mainly as a result of fiscal and monetary burdens imposed on them under the efforts towards macroeconomic stabilization – which protracts the time after which the economy will regain its growth capabilities. The loss in national product caused by the decline in the state sector's output can not – and that for many years ahead – be compensated by the growth in the activity of the private sector, even if the latter is rapidly developing. The same regards the investment. The share of the private sector in global investment must grow, but one can hardly expect growth if effective investment of the state sector is not maintained on an adequate level. Systemic transformation does not exclusively mean the ousting of the latter by the former, but their constructive coexistence as well. That has not much in common with the conception of the so-called "constructive destruction". In reality, those are two qualitatively different philosophies of approach to the process of transformation of the postsocialist economy.

Likewise, the economic growth can be approached in two ways, though, this time, the criterion which distinguishes them is quite different. Namely, short-lasting growth can be considered versus sustainable growth. In the former case it is rather the overcoming of recessionary – or only stagnationary – trends and entry into the recovery phase which is aimed at. At that stage, first, the output which has been lost as a result of recession is rebuilt and, then, augmented, but all the time it is done essentially within the same production potential. It is the degree of its utilization only which is variable, thus we have to do with trends having the character of business cycle fluctuations. In that case, due attention must be paid to potential dangers which may ensue on attempts at setting in motion a short-lasting growth.

One of those dangers consists in the threat of a still greater intensification of the anyhow strong inflationary processes as a result of measures which intensify the effective demand flow. As a rule, those measures require a certain loosening of the restrictive financial policy – both fiscal and monetary – as well as a softer income policy. As a result of increase in demand, production recovery can take place within the existing production capacities through their fuller utilization, including the reduction in unemployment or – in conditions of the early postsocialist economy – rather a slowdown in the pace of its growth only. But an intensification of inflation can also take place if the increase in effective demand brings about an additional rise in prices instead of a growth in output. Then, instead of antirecessionary effects, proinflationary consequences can appear. It is a quite serious danger. In practice, we have to do with both the above-mentioned effects of the growing demand. To what degree and in what time sequence this additional demand flow will be absorbed by price rises and to what extent by the increase in supply, depends on the flexibility and competitiveness of the economic structures. And they are the less, the smaller the extent of the private sector – on the one hand – and the larger the degree of the economy monopolization – on the other hand. By the very nature of the postsocialist economy, the former is small though growing, and the latter is large though decreasing. Hence, the conclusion that the more advanced the given country is on the road of systemic transformation, the more antirecessionary effects through the policy of loosening the financial rigours can be expected. At the early stage of the systemic transformation a too prompt relaxation of financial restrictions will first of all and to a larger extent bring proinflationary results and only later – and to a lesser extent – supply positive response[25]. Obviously, in case of a wrong dosage of the economic policy and its tools, exclusively undesired consequences, and never the opposite, will appear.

As to the second danger, it results from the fact that the economy is, in principle, moving within the existing production capacities. In such a case, there is a possibility that the stimulation of demand will lead to the reproduction of output the structure of which will be similar to that from before the recession. However, that threat is not real as long as the growth in output is a function of response to the increase in effective demand. On the other hand, it would be unfavourable in the long run if such a production growth were promoted by additional, special incentives (e.g. in the form of subsidies or tax rebates) that might reactivate an inefficient real structure of the economy which makes an excessive burden on the state budget and balance of payments.

But it is a balanced and sustained long-term growth which is of key importance. And such a character of growth is determined by the dynamics of the investment level and effectiveness, which, in turn, require compliance with many political, institutional and structural conditions.

An adequate level of investment can be achieved through increase in its effectiveness rather that through augmentation of its rate. To be sure, after a period of sharp decline in investment, a reorientation in the final division of the national product into accumulation and consumption is necessary. The consumption – though it also was bound to fall as a result of the general economic collapse – was to a certain extent protected during recession by a proportionally greater reduction in investment[26], so the decline in the latter's size was significant (table 12).

To raise the rate of investment, or rather bring it nearer to the level attained in the planned economy period[27], requires an appropriate increase in the propensity for saving. An important role in this regard is to be played by the fiscal policy which should bolster the formation of capital. Though it may seem paradoxical, this requires an outright preference for income from capital ownership over remuneration from employment. In some higher income brackets, the latter may even be liable to higher

[25] There also are other opinions about this problem (PTE - Sadowski, 1991, Szymanski, 1991) which rather accentuate the advantages of an early stimulation of demand and, at the same time, belittle the risk of an additional inflationary impulse.

[26] Here, the so-called retardation effect is working, which finds expression in a delay of decline in consumption and its smaller scale than that of decline in output. As a result of additional adjustment processes, the standard of living declines still less (Tendencje, 1982).

[27] That level was very differentiated (Kolodko, 1986), but mostly oscillated within the range from 20 to 25 percent, consequently it must be recognized as relatively high by international standards.

taxation with individual income tax than incomes from dividend or interests on bonds as well as from bank deposits. Because this will encourage the economic agents to increase the savings and will bolster the transformation of free money balances into capital. The effectiveness of that process is, at the same time, a function of the efficiency of the financial system, including the banking system. But in the postsocialist economies, its condition is not satisfactory, which is one of the serious structural barriers to the growth stimulation policy.

Table 12

Investment in selected countries in 1981-1991

in %

	Rate of change					
	yearly average		preceding year = 100			
	81–85	86–88	89–91	1989	1990	1991
Poland	−2.5	4.9	−6.0	−2.4	−7.1	−8.0
Bulgaria[a,b]	4.5	5.8	−16.7	1.3	−10.8	−37.0
CSFR	−0.4	3.2	−8.1	1.8	5.7	−29.0
Romania	−1.3	0.3	−16.8	−1.6	−35.0	−22.0
Hungary	−2.0	0.5	−3.8	5.0	−7.0	−9.0
USSR	3.3	6.7	−3.2[a]	4.7	−4.2	−9.0[c]
Yugoslavia	−12.5	−2.6	−9.2	0.5	−7.0	−20.0
USA	4.0	2.8	−1.1	1.6	−0.1	−4.7
Japan	2.7	9.5	7.0	8.9	10.9	4.0
FR Germany	−1.3	3.5	7.8	7.0	8.8	7.7
France	−1.4	5.4	3.5	7.5	3.5	−0.5
Italy	−0.1	4.7	2.4	4.5	3.0	−0.2
UK	2.5	8.6	−2.0	6.8	−2.4	−10.7
Spain	−1.5	12.9	7.4	13.7	6.8	2.0
Portugal	−4.4	13.7	6.7	8.3	7.3	4.5
Finland	2.3	5.2	−2.5	14.1	−5.0	−14.5
OECD	2.0	5.4	4.4[a]	5.4	3.3	–
EEC	−0.9	6.6	5.7[a]	7.1	4.3	–

[a] 1989–1990
[b] at current prices
[c] data for 1991 regard CIS

Source: Sytuacja (1992).

Thus, the chances of a sustainable and balanced growth depend to a higher degree on the effectiveness of investment than on its absolute level. Using the notions from the planned economy's vocabulary, it is an intensive growth which is needed, since the times of extensive growth have been exhausted still before the fall of the socialist economy. Maybe, it is just that extensive growth that has been the cause of that fall. In such a context one must agree with views that in the postsocialist economy there are prospects of a more speedy growth, but such expectations must be approached with caution. Because, while the scale of wasted investment in the planned economy has been exaggerated (Borensztein, Montiel, 1991), it is obvious that the optimism as to the future might be exaggerated as well. The rate of investment in the postsocialist economy will not be higher than in the socialist economy and it is its effectiveness only than can be higher. There are many arguments that the improvement in the general level of that effectiveness will in particular be fostered by growing extent of private investment. It contributes to the creation of economic relations which better utilize the existing infrastructure, thus improving the functioning effectiveness of the existing production machinery and activities undertaken within its framework (Murphy, Shleifer, Vishny, 1989; Obstfeld, 1991).

The improvement in the effectiveness of investment can and should be assisted by foreign investment too, though – what is to be strongly stressed – its role always is complementary at most. It will be all the more so in the postsocialist economies whose attractiveness is moderately competitive in a world thirsting for direct foreign investment. In 1991, in Mexico alone – and not without reason – more was invested than in Central and Eastern Europe, of course except former GDR. It is estimated than, in global scale, the capital supply is short by USD 80-100 billion yearly, which is the more significant as the supply abilities of Japan and Germany in this field are now lower that still a few years ago. The more difficult it will be for the postsocialist economies to compete for free capitals, mainly against the Latin American countries. They also must compete among themselves by creating as favourable conditions for direct foreign investment as possible. In this field, it is Hungary which best manages the problem; in 1991 alone, more foreign capital was invested in Hungary than in Czecho-Slovakia and Poland together – on the one hand – or in the southern region of Central Europe – on the other hand.

It is worth adding that foreign investment is not only characterized by a higher direct effectiveness, but also contributes to the rise in the general level of investment in the whole economy. This results, in the first place, from its ability to open up and remove the bottlenecks and stimulate the technological and organizational progress. And those are some of the principal factors which stimulate a sustainable economic growth.

The specificity of postsocialist countries consists – as has been said above – in the unavailability of capital repatriation, however in some cases they can expect a certain reduction in external debt, which also must be treated as a kind of additional capital inflow.The scale of this kind of capital supply depends on the degree of a possible debt reduction, but – except Poland which, for political reasons, obtained rather significant advantages in this regard – the abilities of Western financial circles are rather limited and must not be too much relied upon. And an overestimation of those abilities – and of the willingness of Western sponsors and creditors – has been the source of excessive expectations. What is more, some authors draw attention to the danger of a kind of economic euphoria which may be provoked by positive external schocks, including those resulting from possible inflow of foreign capital and the related growth, mainly stimulated by exports (Max Corden, 1991). But the advice which arises from conclusions drawn from the world experience is that all the positive shocks should rather be treated as transitory, while the negative ones – so as if they were to be long-lasting (Williamson, 1991).

The inducement of a sustained economic growth through the raising of the investment level and improvement of its effectiveness requires the existence of a competitive economic environment. From that point of view it is worth to draw attention to the implications which an internally or externally orientated competitiveness-promoting policy in the postsocialist economy may have for the real sphere. In the former case, a policy of counteracting the monopolistic structure and practice in the domestic market which work against the growth (and against stabilization as well) is meant. Out of hardly understandable reasons, such a policy has been neglected in the majority of postsocialist countries. This resulted partly from the time pressure, but equally from the influence of a certain doctrine according to which it is the externally orientated competitiveness policy only which can bring quick results. Under the latter approach, recourse is taken to far-reaching trade liberalization and opening-up of the economy to external competition. This brings noticeable advantages in the form of effects which equilibrate the domestic markets and reduce the scale of inflationary processes (the supply of imported goods quickly grows). But, at the same time, it leads to a reduction in the utilization degree of domestic production capacities, which – if not compensated by the emergence of new production capacities as a result of investment – can work against the economic growth in the long run, too.

So, a certain contradiction exists between the internally and externally orientated competitiveness policy and that contradiction has not been very well solved in the initial transformation period. Here, the orientation of that policy must not be confused with its radicalism. Namely, both in Czecho-Slovakia and Poland we have to do with rather shock-type attempt at the introduction of a market economy, but in the former country the competitiveness policy has not been so strongly warped as in Poland. Thus, in this area too, much depends on the economic policy, which means that certain alternatives are available here. Insufficient emphasis on the internal aspect of competitiveness development is one of the reasons for the protraction of the period of transition to the phase of sustainable growth.

Finally, when setting up an appropriate environment for such a growth, the importance of the development of education and infrastructure must not be ignored. That is the domaine of the state and, therefore, it is also worth while to remind the previously signalled role of its policy in that sphere. Unfortunately, the scarcity of resources – but also, to a certain extent at least, the wrong hierarchy of social preferences of the postsocialist state – limits the activity in the sphere of development of the economic, social and educational infrastructure. No illusions must be cherished that this will not turn against sustainable economic growth, even if it were to happen in a more distinct future only. However, there is no appropriate political force in the postsocialist society which would be able to argue effectively enough the case for the long-range approach to development processes. Excessive – and let us add, naive – faith in an automatic solution of complex problems through lapse of time only in a dangerous and harmful illusion. It is the strategy that determines the economic growth.

In sum, three steps leading to a sustainable economic growth are to be discerned (Selowsky, 1991). In the first of them, it is the stopping of decline in output and, later, its recovery as well as macroeconomic stabilization that are aimed at. In the second step, a process of economy deregulation and liberalization must take place, and in the third step only a potential for sustainable growth emerges. The process is neither easy nor, all the more, short-lasting. But it can be crowned with success in different systemic environments, including the postsocialist economy. An ideal state would be such in which:

$$r > CPI > U \qquad /9/$$

with a simultaneous as favourable as possible situation with respect to both internal and external financial equilibrium illustrated by the size of triangle "d" in the MSP model. For example, the Malesian economy has recently been in approximately such a situation. Satisfactory experiences are more numerous, but they still are not – and probably will never be – dominant. As to the postsocialist economy, there should be no doubt that it is still in for a long and painful road to the phase of sustained and balanced economic growth which will be reflected in the steadily growing psm coefficient.

6. Threats and prospects

As far as the threats and prospects of growth in the postsocialist economy are concerned, it is the former that, unfortunately, are more salient. To be sure, in a more distant time horizon, the latter seem to look more promising, which however does not at all mean that the threats for development processes will be removed. The pursuit of an enlightened and sophisticated economic policy aimed at a sustainable and balanced growth is difficult, while commitment of errors which entail destabilization and economic stagnation is easy, and that the more so, the less professionally fit the new political elites and managerial staffs are.

As well theoretical considerations as lessons learned from practical experience of other economic systems lead to the conclusion that the transition from stabilization to growth is not automatic. It requires as well a skilful economic policy pursued by the state and efforts on the part of the society as a support by the external world. That also regards the postsocialist economy, but in its case the situation seems still more difficult. Putting aside the greater than originally expected difficulties in macroeconomic stabilization as such, the release of the growth mechanism requires a greater effort in the field of structural adjustments than in the case of underdeveloped market economies.

Critics of the traditional approach to structural adjustments stress that its advocates and practicians accept as given that the market by itself will secure the availability of organizational (managerial) and technological skills necessary for an effective functioning of private enterprise. But that is not the case, hence the arbitrary assumption of the existence of the basic factor of sustainable growth – the human capital with desired skills – can not be adopted and it is just the state which has to help the development of that factor (Pegatienan, 1991). It seems that in this regard the postsocialist economy is in some cases in a better position and in some other cases in a worse position in comparison with the underdeveloped market economies; since, in general, the education level of the postsocialist societies is relatively high, but often ill-matched to the needs of the market economy. However, it can be estimated that the adaptation process in this sphere is going on rather quickly and the general high level of schooling and education of the labour force should make a factor conducive to intensification of growth and utilization of the advantages of the market economy.

It may seem that the economic populism is one of serious threats to the efforts directed towards stabilization and inducement of a 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, Edwards, 1991, p. 9). Those authors point out three phases of a populist economic policy.

During the first phase, the politicians are fully confirmed in their belief in the rightness of their approach, diagnoses and recipes. The output is growing, real wages are rising, employment is maintained on a high level. Inflation is kept under effective control, there are no shortages, above all owing to the financing of imports with the 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 of the demand for domestic goods and because of the growing shortage of convertible currency. While during the first phase the decline in stocks was a desired phenomenon, now it makes a problem already. Price adjustments, devaluation of the exchange rate and reintroduction of its administrative control become indispensable. The inflation is intensifying and the budget deficit is deepening.

In the third phase, severe shortages and drastic acceleration of inflation as well as shortage of convertible currencies lead to the flight of capital and demonetization of the economy. The condition of the budget is still more deteriorating as a result of decline in real tax revenues and growth is subsidies. Real wages substantially fall as a result of governmental stabilization efforts, but the latter do not bear fruit any more.

Finally, in the fourth phase, recourse to the orthodox stabilization is necessary, mostly through the use of IMF programs. But now real wages must fall to a still larger degree, much below the level having been implemented at the starting-point of the whole sequence. Now the situation is more difficult also because capital flight has taken place – since it is internationally mobile – while the labour force remains at home. Obviously, the new orthodoxy is implemented by a fresh government already (Dornbusch, 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. Its characteristics for six countries over the past two decades are presented in table 13.

This presentation idenfities political goals defined as populist and characterizes the pursued economic policies, especially the fiscal, income and currency policies, in evaluating them according to a three-point scale. What seems most interesting, is the fact that conclusions have always been drawn from one's own errors, while other people's errors have been ignored.

Will it happen once more? Are this time, too, the symptoms of the postsocialist economy's future to be sought in the Latin American past? Certainly, there is no such inevitability, but equally certain is the fact that such a threat exists. When studying the programs of certain – often influential and usurping the right to govern – parties in Central and Eastern Europe as well as in the post-Soviet countries, one can notice an almost ready-made scenario of advancing on the path traced out by the above-described first and second phases of economic populism. To be sure, in those programs there is no talk about the third and fourth phases – since both such a vision and political responsibility are lacking. However, those phases would be bound to come, because such is the implacable logic of any policy based on economic populism.

Here, too, sufficient and necessary preconditions for the fulfilment of the populist threat are present. And so, one may assume that the reality of the early postsocialist economy has already met the necessary conditions.

Table 13

Latin American governments ranked according to populist tendencies

Government	Political Goals			Economic Policies		
	Labor Base	Business Alliance	Anti-oligarchy, Foreign Capital	Budget Deficits	Wage Increase/ Price Controls	Overvalued Exchange Rate
Allende (1970–1973) Chile	++	+	++	++	++	++
Peron (1973–1976) Argentina	++	+	+	++	++	++
Garcia (1985–1990) Peru	++	+	++	+	++	++
Sarney (1985–1990) Brazil	+	++	+	++	++	+
Echeverria (1970–1976) Mexico	+	++	o	+	+	++
Perez (1974–1978) Venezuela	+	++	o	+	+	++

++ – very important/large;
\+ – moderately important/large;
o – not important/large.
Entries represent peak of populism during given presidential period.

Source: Kaufman, Stallings, 1991, p.17.

Problems resulting from the drastic fall in real wages and other incomes or from the rapidly increasing unemployment are sufficiently great. Unfortunately, the aversion of many circles to the inflow of foreign capital is not subsiding, too. There only is, as distinct from Latin America, no opposition to domestic oligarchy, since in the postsocialist Europe the latter does not exist. Nevertheless, all that is not yet enough for the economic populism to dominate the practice, since other necessary conditions would also have to be met. From that perspective, it is true that populist-tainted movements, policies and governments exist (Kaufman, Stallings, 1991), but a turn towards populism is still miles away. So, without ignoring the hazard of economic populism – and that, in the case of postsocialist economies, of a right-wing character rather – I think that most facts make the case for the probability that common-sense pragmatism will gain the upper hand in the economic growth policy. However, that is by no means predetermined.

The problem of economic growth essentially is an economic issue, but it also is strongly entangled in politics (Alesina, 1991; Roland, 1992; Kolodko, 1992c). All the more it must be stressed that a sustainable and balanced economic growth in postsocialist countries will not be possible if not supported in the sphere of institutions and political relations. In that field, too, the course of events will be determined by both the threats and prospects of growth. Political polarization – so typical of economies under transformation – increases the uncertainty about the future policy and even system, and that in such key matters as property relations. That must necessarily turn against the growth, since it works against savings and investment. In addition – as I have already stressed – in politically uncertain times the politicians still more tend to shorten the time horizon within which they perceive the effects of their decisions. And that works against the economic growth, since it is a factor which discourages investment of long time of return. Finally, an excessive political differentiation or outright quarrel entails delays in making the indispensable adjustment decisions. E.g. in Poland, budget could not be voted throughout the former half of 1992. In countries emerged from the disintegration of USSR – and a more spectacular case is hardly imaginable – the lack of coordination of political measures and the protracted constitutional crisis make the prospects of macroeconomic stabilization and growth more and more distant.

Finally, six conclusions can be formulated which arise from the whole debate on the determinants and implications of stabilization, recession and growth in the postsocialist economy. Firstly, the perspective must not be cut down, since the processes in question are, by their very nature, long-term ones, and errors in economic policy committed during the systemic transformation make them still more protracted.

Secondly, one must not expect too much – and all the more, promise it to others. If favourable and desired effects sometimes appear – and surely they will – it is better they should surpass the expectations rather than painfully deceive people.

Thirdly, one must rely on oneself in the first place. The economic reasons of state call of a permanent increase in 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 that on a limited scale – from external sources of financing the growth.

Fourthly, one must learn as much as possible from others, since the majority of errors which could have been committed have already been somewhere committed 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 conclusion drawing is not in short supply. What is worse, in connection with the ongoing postsocialist transformation, there will be still more of it, may it only turn out as little as possible.

Fifthly, in spite of the fact, that we are talking about the postsocialist economy as a kind of subsystem of world economy, a uniform course of events must not be expected within it – neither with respect to macroeconomic stabilization and sustained economic growth. Some countries will be more successful, others less, and in the foreseeable future the state of affairs within the whole group may become still more differentiated.

Finally, sixthly, 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 will not be missed, depends, above all, on the state's enlightened, imaginative, active and responsible economic policy and strategy.

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Index

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