

**Working
Papers** *Institute of Finance,*
Warsaw **if**

No 16
1990

Grzegorz W. Kołodko

HYPERINFLATION AND STABILIZATION
IN POSTSOCIALIST ECONOMIES
(THE CASE OF POLAND, VIET NAM
AND YUGOSLAVIA)

INSTITUTE OF FINANCE

WORKING PAPERS No 16

Grzegorz W. Kolodko

**HYPERINFLATION AND STABILIZATION
IN POSTSOCIALIST ECONOMIES
THE CASE OF POLAND, VIET NAM AND YUGOSLAVIA**

Hyperinflation and Stabilization in Postsocialist Economies The Case of Poland, Viet Nam and Yugoslavia¹

One might think states and peoples have had so many bad experiences with inflation that politicians at the helm of these states would do everything within their power to avoid inflation and, in particular, its very intensive shape, i.e. hyperinflation. However, this has not been the case. After the big inflations of the twenties and the post-war inflations of the forties, we still contemporaneously witness intensive, economically, socially and politically extremely painful inflationary processes. And the eighties will be particularly engraved in the history as a period in which the inflation has assumed an exceptionally dynamic character with respect to some countries. This regards, in the first place, Latin America, but not exclusively. Not without reason inflation of particular intensity has also affected countries which, according to the other day's economic doctrine, were supposed to be completely immune from this economic illness.

This paper examines some theoretical questions regarding very high and rampant inflation and antiinflationary policies from comparative perspective in three of these countries, e.g. Poland, Viet Nam and Yugoslavia. In the first section the phenomenon of hyperinflation is very briefly discussed. In the second section the notion of the "postsocialist economy" is considered. The third section examines the feed-backs between stabilization policies and the systemic transformation going on in the post-communist world. The fourth part deals with the similarities and differences between the three cases being discussed here. In the fifth part an effort to solve the dilemma: orthodoxy or heterodoxy is undertaken. And - finally - the sixth section of the paper considers the impact of the stabilization policies implemented in the postsocialist economies on the real sphere of the economy, mainly with the respect to an output, unemployment and foreign trade.

¹ This paper has been revised while the author was a Senior Visiting Fellow at the Department of Economics of the European University Institute (EUI) in Florence (Italy) and presented to 1st Conference of the European Association of Comparative Economic Studies held in Verona (Italy), September 27-29, 1990. The author is grateful to Domenico Mario Nuti for his helpful comments and useful suggestions and wish to express his acknowledgements for the scholarship provided by the EEC under the PHARE program.

1. Hyperinflation

On the highest generalization level, inflation can be assumed to be a uniform phenomenon which, in each case, can be described by a single, universal definition, while being divided into a number of forms and types distinguishable according to their original and secondary sources, their mechanisms, the ways of their manifestation as well as to their effects and the methods of counteracting them². If approached in the above way, *inflation is a process of general price rise or pressure towards such a rise caused by growing production costs and an excessive demand to supply ratio at stable prices, a depreciation of money accompanied by and an increase in its supply as well as by an uncontrolled redistribution of wealth and national income* (Kolodko, 1987, p.150). This definition is comprehensive enough to cover inflationary processes appearing in centrally planned economies as well - both traditional and being reformed; since in this system, especially in the period from before systemic reforms, the inflation mainly appeared in its shape and more rarely in the form of open general price rise, the latter form being typical of inflation in the market economy.

Economies generally defined as socialist ones - both in their traditional, centrally planned form and in their more or less reformed, modified forms - have always been though in different ways involved in inflationary processes. A great differentiation in this field can be noticed with respect to both time and space. So, it is possible to point out in each individual country distinct periods differing from the point of view of the intensity of inflationary processes (for example, in Poland, ranging from vestigial price inflation and insignificant shortages in the sixties to the two-digit open inflation and very vast shortages in the latter half of the eighties) as well as a very different inflation scale contemporaneously appearing in various countries (e.g., in 1989, four-digit inflation rate in Yugoslavia and one-digit rate in Czechoslovakia). These processes are ever better understood from the theoretical point of view, though many questions are still open in this field. This especially regards the hyperinflation and stabilization in postsocialist economies. These problems are the more theoretically and politically important because it can not be excluded that economies which have so far been privileged to avoid it will also enter the phase of very strong inflationary processes, along with all the economic and political consequences. However, such a development is not inevitable, though the danger of getting involved in hyperinflation is serious.

As far as socialist economies are concerned, it has turned out that in some cases - thus far only three countries (leaving aside Nicaragua) have been concerned - inflationary processes have grown to dimensions which can be defined as hyperinflation. I say that these processes can be defined as such, since this notion is variously defined in the literature. We adopt it as defining inflationary processes of such intensity as to completely erode the financial system, unequivocally slow down economic growth and completely break the ties between the productivity of labour and its remuneration. So, it is evident that hyperinflation must have, by its very nature, at least two attributes. Firstly, it must be characterized by a very high growth of the overall price level, though it is arbitrary to set any formal quantitative criterion here. Nevertheless, some economists do it, in proposing, for example,

² More on the typology of inflationary processes see Nuti (1986) and Kolodko (1987).

the limit of fifty percent monthly (i.e. nearly 13 thousand yearly)³. This, however, does not seem convincing, since it is the above mentioned qualitative characterization of the process that is more important in this case.

Secondly, hyperinflation must be characterized by a certain persistence of the process of very considerable price level rise. But here, too, attempts to formally decree a quantitative criterion (e.g. at least one-year period) are arbitrary. Of course, hyperinflation certainly is something more than once and for all price explosion, or two- or three-month of super fast price rise. So, we will have to come back to his problem, but I will nevertheless use the notion of hyperinflation in the context of the whole paper, in keeping our distance from it wherever necessary⁴.

2. Postsocialist Economy

The second important comment regards the title notion "postsocialist economy". It is rather blurred and susceptible of various interpretations. One can say that postsocialist economy is a social, economic and political system in which a historical process of transformation from a modified planned economy (or, in other words, from socialist economy being reformed) and from a bureaucratized socialist state into a mixed market economy and democratic political system is taking place. The basic features of such a transitional state are: more rapid growth of the private sector (in its different forms) than of the public one, remonetization of economic relations, reorientation of the macroeconomic policy towards instruments of broadly conceived financial policy, abolishment of command-type planning as capital allocation tool as well as initiation of the state-owned sector reprivatization process. In the political sphere, the postsocialist economy is characterized by the development of parliamentary democracy institutions and of multiparty system as well as by the departure from domination by a single ideology. One can say we have to do with post-socialism in the above sense in case of irreversible crumbling of the three pillars on which the system of the so-called real socialism rested, namely: the hegemony of a single (Marxist-Leninist) ideology, the monopoly of a single (state) ownership form and the omnipotency of a single (communist) party - and such exactly is, in my opinion, the character of systemic transformation processes being discussed here.

Such facts - though on differentiated scale - have been taking place with particular intensity beginning with the latter half of 1989. The course of the associated events not yet justify the use of the term "postsocialist" in every case. Still, it is a very dynamic process and the situation with this respect will change in the above-outlined direction in those countries too which have not yet entered their postsocialist development phase. But, in this monograph, it is not exactly the systemic transformation process itself that we are interested in, but the hyperinflation processes accompanying it in certain cases and the attempts to

³ See - for instance - Cagan (1956)

⁴ Sometimes other definitions can be found which propose to single out particularly intensive inflationary processes without giving them the name of hyperinflation. Here, terms such as stratoinflation, superinflation and magainflation can be mentioned (see Dornbusch, 1990).

counteract them by an appropriate stabilization policy. In particular, it is the recent years' Polish, Yugoslav and Viet Nameese experience that is concerned in this paper.

At least two problems require comment here. First of all, there is no clear demarcation line between what we have defined as modified planned economy (or socialist economy being reformed) and postsocialist economy. This dividing line is - at least in the economic sense - liquid, especially in the situation where so many phenomena are evasive because of being *in statu nascendi*. And it is exactly against this background that we can say the Polish economy is more postsocialist than the Yugoslav one, while Viet Nam can be credited with attributes of this development phase to the least degree only, since it is a country which still rather remains - though it now is difficult to foresee for how long - a socialist economy being reformed (albeit with more success than in other countries)⁵. But after having made these remarks, we nevertheless propose to use just the definition "postsocialist economy" when further discussing the economies of the three above-mentioned countries.

Secondly, the question arises to what degree the hyperinflationary processes - with all their diversity and specificity - which affected Poland, Viet Nam and Yugoslavia at the end of the eighties as well as the attempts at stabilization made in their consequence, resulted from the postsocialist development phase and, more exactly, from the reform of the economy and more broadly conceived systemic transformation.

3. Stabilization versus systemic transformation

An examination of three hyperinflation and stabilization cases in postsocialist economy as well as the knowledge of already rich experience concerning stabilization efforts in other countries reveal the key importance of sequencing the stabilization policy measures. Because, irrespective of the character of antiinflationary therapy used - whether it is more like the orthodox or heterodox approach, whether we have to do with a shock approach of "cold turkey" type or with gradual operations - there always are two elements of key weight: the intensity (level) of individual instruments of the macroeconomic (especially financial) policy and just the sequence of operations⁶.

This sequence is to be perceived in the context of comprehensive, package-type approach to antiinflationary strategy, since it is the only one which gives a chance to get inflation under control. However, the comprehensiveness of antiinflationary policy raises, from the very beginning, the problem of sequencing the measures to be taken. It is evident that this sequencing has not been identical in Poland, Viet Nam and Yugoslavia. This fact had its different causes and consequences, among others from the point of view of the effectiveness of the stabilization policy implemented. On the other hand, the character of inflationary processes and the economic situation as a whole required a somewhat different sequence of measures in each of the cases under discussion.

In my opinion, the finally adopted sequence resulted from three groups of reasons.

⁵ On Vietnamese reform process see Gotz-Kozierkiewicz, Kolodko (1990).

⁶ The problem of stabilization and the sequencing of the postsocialist reforms are extensively dealt with by Kolodko (1990a), Kornai (1990) and Nuti (1990a and 1990b).

First, the acceptance of certain objective arguments as to the required concentration of particular microeconomic, financial (in the first place, monetary) policy tools and as to their effectiveness with respect to the inflation dynamism. Hence the problem of the height and flexibility of the interest rate, in particular on household deposits, was differently solved in each of the three countries.

Second, the approach to the dilemma: shock-against-gradual therapy was diverse. In Poland, the political option was falsely formulated proclaiming that a one-stroke shock approach was the only one which could give a chance to curb high inflation, the allegation being based on world experiences which supposedly testified to the rightness of such an approach. The allegation was not true. It seems that, in taking this approach, shock therapy, though indispensable, was mistaken for one-stroke therapy, this finding expression in declarations of the "promptly-or-never" type. It might have had certain favourable psychological effects, even this being however by no means sure⁷. In Viet Nam, in turn, a gradual approach to stabilization policy was clearly visible. The concentrated package-like approach of Spring 1989 had been deliberately prepared by several-month operations enabling a correct functioning of many economic policy tools which were in a coordinated and consistent way applied over the following dozen-or-so months. Whereas, in Yugoslavia, a shock-type therapy was used the scale of which, however, had not to be as large as in Poland because of the different characteristic of the economic situation - among others owing to the hyperinflation having lasted for several years already - at the time of the start of the stabilization program. Thus, in Yugoslavia, we had to do with a kind of hybrid between the shock-type and gradual therapy.

Third, the stabilization under examination must be looked at within a much broader context of systemic conditions and transformations, since in each case we have to do with a different situation, and that on both the economic and political planes. As to the former, the degree of advancement of individual countries in the systemic transformation process is substantially different. I have stated earlier that the Polish economy was to a higher degree postsocialist than the Yugoslav one, while the Vietnamese one must still be rather considered as a socialist economy in the course of being reformed. Against this background the question arises about the real macroeconomic policy priorities at different stages as well as about the resulting sequencing of this policy. It seems that in Poland the systemic transformation was given markedly higher priority than the stabilization, and that contrary to official declarations made, in particular, in the program preparation phase and in the first months of program implementation. What is more, the finally adopted shape of the stabilization policy has, logically, been subordinated to the intended directions of the systemic transformation. In other words, since the transformation of the economy into market economy was accepted as the highest priority of the whole policy, particular solutions of the stabilization program had to be subordinated to it. Therefore, in the Polish stabilization package, even elements menacing with further destabilization can be found, among others in the shape of an abrupt, sometimes too far-reaching, withdrawal of budget subventions, such withdrawal not always being indispensable from the point of view of stabilization. Instead, it is justified (through also not always and not fully) by the desire to accelerate in transition to market economy.

In Yugoslavia, in turn, it can clearly be noticed that it is the stabilization that, in the whole sequence of measures, has been actually, and not only declaratively, brought into the

⁷For detail considerations of Polish stabilization program see Kolodko (1990b).

foreground; since it has been actually assumed by the macroeconomic policy that far-reaching institutional changes should be preceded by an effective stabilization. This is to a large extent justified and understandable because, in Yugoslavia, the development path of inflationary processes has been different. There was no need to use hyperinflation in order to provoke and, at the same time, accelerate certain systemic transformation processes. But this was the case in Poland and because of it I have defined this hyperinflation as induced (Kolodko, 1990b). So, after certain favourable effects of stabilization efforts, it is in mid-1990 only that in Yugoslavia the emphasis is being shifted from stabilization - with a great, greater than in Poland, reserve in its assessment - towards systemic transformation.

Whereas in Viet Nam, the problem looks differently since, there it is not yet a systemic transformation in the sense I attribute to this notion, but the preservation of the existing social and economic system that is intended. This aim is to be achieved, on the one hand, by a marked-oriented and effective - in comparison with not especially good experiences of other countries - economic reform, without infringing the substance of the socialist system and, on the other hand, just by stabilization.

While, on the political plane, the stabilization in Poland is superimposed on an intense acceleration of the process of fundamental political changes (this having implications both for the stabilization itself and the institutional political changes), in Yugoslavia it precedes these changes⁸, whereas in Viet Nam it has to avert the need for such changes. This is at least what can be concluded from a certain reconnaissance of the political situation in that country. Actually, an economy stabilized over a given period makes a factor which eases the pressure for systemic reforms but, at the same time, makes them still more indispensable - and more difficult to be implemented - at a future date⁹.

4. Stabilization implications and effects: similarities and differences

Even a cursory comparative glance at the consequences of stabilization in Yugoslavia, Poland and Viet Nam shows they are substantially differentiated. This results as well from different social and economic conditions prevailing at the moment of initiating the antiinflationary programs as from diverse character of the stabilization programs themselves and the different course of their implementation. With respect to conditions existing before the stabilization as well as to its impact on the development of situation in the following period, at least five aspects which differentiate the countries under discussion must be pointed out.

Firstly, it is the character of the inflationary processes in the period preceding the hyperinflation that we are concerned in. First of all, the inflation rate was different. The highest inflation level was observed in Yugoslavia, in Viet Nam it amounted to 300-400 percent over a three-year period but without the trend towards gradual acceleration of the inflationary processes which was characteristic of Yugoslavia, whereas in Poland the quasi-

⁸Here, we put aside other complex conditions of the process of democratic political changes which, in Yugoslavia, is particularly complicated because of the multinational and federative character of the state.

⁹For indispensable conditions of successful systemic reforms see i.a. Kolodko (1989), Kornai (1990) and Nuti (1990b).

hyperinflation lasted for half-a-year only and, in addition, was of induced character. So, the observed differentiation regards both the height of the open price inflation rate and the duration of this process. This evidently must also have influenced the assumptions and the implementation of the stabilization programs. It was, in the first place, the different hyperinflation progress that produced in each of the countries under discussion different effects on the scale of internal and external equilibrium; since the shortages accompanying the intensive price inflation were lowest in Yugoslavia's case and highest in Viet Nam.

Secondly, the scale of the distortion of prices *sensu largo* was unequal. Just immediately before the stabilization (February 1989 in Viet Nam and December of the same year in Yugoslavia and Poland) the largest deviations from the market-clearing level appeared in Poland, while being decidedly least in Yugoslavia. In Viet Nam's case, the sound approach in the form of gradual modifications contributed to reduce the scale of these deviations so that, at the moment of the initiation of the essential stabilization package, the scale of indispensable corrections had not to be as large as in Poland. It must be clearly stressed that the relatively smallest extent of distortions of prices in their broad sense (relative prices of goods and services, wages, interest rate and exchange rate) in Yugoslavia was just a result of a long-lasting inflation which finally passed into the hyperinflation phase. Whereas, in Poland, the galloping inflation of 1981-1988 was, from this point of view, futile, since it steadily reproduced a similar structure of prices at their ever higher level (and, also, at an ever higher level of incomes and costs). Unfortunately, also the hyperinflation induced in the latter half of 1989 has left many problems in this sphere unsolved, putting them off to a later date.

Thirdly, the systemic characteristic of individual economies under consideration was different, too. I have already pointed out many differences in this field, among others, when trying tentatively to define the notion of postsocialist economy. This characteristic is of great importance in so far as economic agents differently behave in the face of different systemic environments. So, enterprises differently react to restrictive fiscal and monetary policy in Yugoslavia and Poland, exactly because of the system-based different degree of economic self-dependence and methods of management. The self-managing Yugoslav enterprises - in spite of all their imperfections - can be expected to behave in a more flexible manner than the ponderous, highly etatized and bureaucratized enterprises in Poland. Of course, an additional contributing factor was the much smaller scale of economic disequilibrium in Yugoslavia and the resulting relatively larger extent of competition.

Consequently, a much larger scale of negative microeconomic adjustments had to be expected in the case of the Polish economy, along with a larger recession scale resulting therefrom. Because, in Yugoslavia, decidedly more market-like behaviours by enterprises could be observed in the initial stabilization period. The situation was similar in the Southern part of Viet Nam where the still present market economy traditions favourably manifested themselves upon imposition of certain market economy rules, mainly in the form of hard budgetary restrictions, on the still state-owned or cooperative enterprises. Whereas in Poland warnings that, in the initial phase of the stabilization program implementation, the enterprises would react to the new environment mainly (if not exclusively), on the one hand, by negative adjustments in the form of attempts to raise prices and, on the other hand, by limiting the absolute production volume in response to the shrinking stream of effective demand, were taken no heed of by policy makers. It was only the drastic and, by no means short-lived break-down that forced - though to late and on

insufficient scale - some modifications in certain systemic solutions and in the financial policy carried out under them.

Fourthly, different trends appeared with regard to real economic processes. In Yugoslavia, either stagnation or economic recession accompanied by a very high unemployment - of 12-14 percent order - had been observed for many years already. In Poland, certain recessionary trends began to manifest themselves since May 1989 only, this recession being till the stabilization period very shallow and finding expression in an insignificant fall in industrial production. In the scale of the whole 1989, the global domestic product fell by 1.5 percent only. This was accompanied by labour shortage typical of the socialist economy. So the open unemployment did not yet show up at all. Whereas in Viet Nam, we all the time had to do with economic growth, albeit accompanied by a significant (though difficult to be precisely assessed) structural unemployment. What is more important however, the Vietnamese stabilization was perfectly timed from the point of view of real processes. The years 1988-1989 were characterized by good crops in the agriculture, and especially the rice crops greatly facilitated the stabilization efforts. So, it can be concluded that, from the point of view of the character of reproduction processes, the most favourable conditions conducive to stabilization existed in Viet Nam, and the least favourable ones - in Yugoslavia.

Finally, fifth, the situation with respect to external disequilibrium and foreign debt was different in each of the countries under discussion, though very unfavourable in all of them. As at the end of 1989, the indebtedness in convertible currencies amounted to USD 21.7 billion in Yugoslavia, 42.1 billion in Poland and 2.4 billion in Viet Nam¹⁰. These absolute figures must be related to export revenues in convertible currencies earned by each of the above three countries in 1989. They amounted to about USD 20 billion in Yugoslavia, 8.5 billion in Poland and 0.9 billion in Viet Nam. So, the indices of the ratio between hard-currency debt and dollar revenues from exports amounted to: 108.5, 498.6 and 261.8 percent, respectively¹¹, thus placing Poland on the most unfavourable position.

In the first half-year of the implementation of the stabilization programs, the situation changed in diverse directions in each of the three countries. Here, the fact must be pointed out that the Yugoslav debt was substantially reduced down to about USD 16.5 billion in mid-1990 with simultaneous growth of official reserves from USD 6.1 to 8.7 billion over the first six months of this year. Whereas in Poland the debt was further growing - mainly as a result of its rescheduling in view of the country's inability to fully meet its obligations¹² but, like in Yugoslavia, the official reserves rapidly grew (from USD 1.65 billion at the beginning of 1990 to 4.85 billion in mid-1990). Such large increments in the reserves put the problem of further foreign aid to economies implementing stabilization programs in a somewhat different light. It is well known that in Yugoslavia's case the considerable

¹⁰ In Viet Nam's case it is to be stressed that debt denominated in convertible currencies constituted but a small part of the country's total indebtedness. Because, at the same time, Viet Nam owed SUR 10.3 billion to COMECON countries of which mainly to the Soviet Union. Whereas in Poland's case the debt in Roubles amounted to 5.8 billion.

¹¹ The above indices regard gross indebtedness. Data for Yugoslavia and Poland - according to World Bank statistics; for Viet Nam - according to International Monetary Fund.

¹² For more details on the problem of indebtedness of the COMECON countries and Yugoslavia - see Malecki and Kolodko (1990).

trade balance surpluses¹³ led to a certain difficulties in obtaining structural adjustment loans (SAL) from the World Bank, while in Poland's case they were not without influence on the very reticent attitude of the leaders of world's seven most developed countries (so-called G-7 group) during their meeting in Houston in July 1990. This shows that negotiations on foreign debt, especially on its reduction, should be conducted parallelly to negotiations on adjustment programs with the International Monetary Fund; since, later, the bargaining power of the countries concerned will be weakened, this having been experienced among others by Yugoslavia and Poland. Whereas, in Viet Nam's case the problem was irrelevant, because its stabilization program had been prepared quite independently, without concluding any agreement with the IMF.

5. Orthodoxy or heterodoxy?

When examining the effects of the three stabilization programs under discussion, substantial differences can be easily noticed. In Viet Nam's case, this mainly results from the different character of the program which, quite surprisingly, proves to approximate - more than the other two programs - the IMF orthodoxy, and that in spite of having been developed and introduced without participation of this organization. As to Yugoslavia and Poland, the programs are very similar in substance. These two packages include elements of both orthodoxy and heterodoxy, while the former dominate in the Polish stabilization and the latter prevail in Yugoslavia's program, since, here, more freezing measures (half-year freeze on wages, partial freeze on prices) were used. In the Polish stabilization a full wage freeze was impossible because it would have led to a still greater fall in the real wage level. Therefore, recourse was taken to quasi-freeze measures by restricting the admissible increase in the wage fund to a very limited scope in relation to the inflationary rise of the living cost. But the fact remains that in Poland the real wage reduction (by as much as about 28 percent on the average in 1990) was greater than elsewhere and that it was just the Polish stabilization which was socially most costly, anyhow not only from the point of view of real wages.

So, why - in spite of the great similarity of both programs - their effects were so different? Why did the price inflation rate in Yugoslavia fall from 64 percent monthly in December 1989 to 9.4 and zero percent on monthly average in the first and second quarters of 1990, respectively, while in Poland's case it grew from 17.7 percent in December to 35.7 percent (first quarter of 1990) and then only declined to 5.6 percent (second quarter) on monthly average, respectively? In other words, in Yugoslavia in the second three-month period after stabilization, the inflation in yearly scale was equal to zero, while in Poland it still remained the highest in Europe amounting to as much as 100 percent annually¹⁴.

Well, this question has already been indirectly answered, namely the problem

¹³ In Viet Nam it amounted in 1989 to USD 337 million as against total revenues of USD 916 million, thus to as much as 37 percent. This surplus was, to a large extent, spent on purchase of gold in support of the stabilization of the domestic currency.

¹⁴ In Viet Nam, in turn, the mean monthly inflation rate in the first half-year after stabilization (April-September 1989) amounted to 0.1 percent, with simultaneous decrease in industrial production estimated at 3 percent only and with a sustained trend towards GDP growth. See Gotz-Kozierkiewicz-Kolodko (1990).

consisted in the fact that the programs were similar (though not identical)¹⁵, but circumstances under which they were implemented were different. The stabilization program structured in this way fitted very well the Yugoslav conditions, but the same could not be said in the Polish case. In particular, the hyperinflation in Yugoslavia was, apart from some circumstances mentioned above, to a large extent of monetary character stimulated by the long-lasting budget deficit. So, it resembled to a certain degree the known Latin American inflations¹⁶ which by no means can be said about the Polish quasi-hyperinflation of the August 1989 to February 1990 period. Thus, in this context, the reliance of the stabilization package on the so-called nominal anchor in the form of fixed nominal exchange rate was much more convincing in Yugoslavia than in Poland; since in the former case the hyperinflation - through its long duration and the impact of this fact on inflationary expectations - currently equilibrated the financial streams in the whole economy by appropriately depreciating them. At the same time, they were almost fully indexed in relation to convertible currencies (in this case - to Deutsche Mark which decided on the choice of the latter's fixed exchange rate as nominal anchor). In such a situation it is enough, indeed, to "merely" stabilize the exchange rate in order to stabilize the purchasing power of the domestic currency and - in consequence - the whole economy, too. One can think it is just this kind of theoretical reasoning that has substantially influenced the Polish economic policy of the end of 1989 which has led to an induced hyperinflation rather than counteracted it.

6. Stabilization and the real sphere

Differences in the initial conditions, on the one hand, and a more or less considered implementation of the stabilization programs, on the other hand, have also brought about fundamentally different effects on the real economic processes which, in the longer run, will finally be crucial for the success or failure of the whole operation. In this context, at least two important aspects are to be pointed out, namely the already mentioned impact on the current account of balance and external equilibrium as well as on the recession in the production sphere.

So, as to the former aspect, the considerable surpluses in foreign trade in Yugoslavia and Viet Nam resulted from a clear dynamization of exports with a simultaneous increase in imports though on a substantially smaller scale. Whereas in Poland's case, the significant and, what must be stressed, unforeseen under the stabilization program, size of the trade surplus in both convertible and non-convertible currencies was a result of a drastic reduction in imports rather than of a large increase in exports¹⁷. This fact, in turn, had an

¹⁵ As far as important differences between the stabilization programs under discussion are concerned, the following elements within the Yugoslav program are to be pointed out: a far-reaching foreign trade liberalization, government interventions inclusive of centrally financed imports whenever economically justified, though doctrinally rather inconsistent with the whole package, a more considered and stable monetary policy of less pro-recessionary character, the right choice of Deutsche Mark as nominal anchor.

¹⁶ See Inflation (1988).

¹⁷ In January-July period the export increased by 6.3% and the import decreased by 31.1% (as compared with the same months of 1989). These tendencies have contributed to the trade surplus of USD 2,692 mln and SUR 2,477 mln. With respect to trade settled in non-convertible currencies, the high trade balance surplus was also caused to the extent of about 20 percent by exceptionally favourable terms of trade indices in 1990. In the first half of this year they amounted to 112.

unfavourable impact on the real economy sphere, in additionally augmenting the scale of recession caused by the extremely restrictive fiscal, monetary and wage policy. Against this background it is easier understandable why, in Poland, the industrial output (measured by sold production of the state-owned and cooperative sectors) fell by as much as 30 percent in the early half of 1990, while in Yugoslavia it decreased by 10 percent "only".

What is more, a detailed examination shows that the composition of these two recessions has been distinctly different. In Yugoslavia, with a shallower overall recession size, an above-the-average fall was noticed in heavy industry branches which constituted - because of their typical low efficiency - the greatest burden on the state budget and balance of payments. Whereas in Poland, it was the light industry that was most heavily affected by the recession¹⁸. Likewise, more favourable from the structural point of view was the small recession observed in the Vietnamese economy, although structural problems are just in the latter country more complicated, among others because of the very low economic development level¹⁹.

Finally, the different effects of stabilization on household incomes must be noticed here in the context of the outward opening which accompanies the stabilization and postsocialist systemic transformation. This aspect has, thus far, played a relatively lesser role in Viet Nam where the average monthly wage fluctuates between 15 and 20 US dollars, although the country's society is now decidedly more open than not long ago; this especially manifests itself in contacts with China and Thailand. While in the case of Yugoslavia and Poland much more important, in particular in view of the historical changes which are taking place in Europe on the verge of the 90s, is the fact that average wages expressed in convertible currencies are very low, since they amount to about USD 300 monthly in Yugoslavia and USD 100 in Poland. This is in so far interesting as this relation by no means reflects the above-mentioned differences in the per capita GDP level between these two countries (three times against one-and-a-half times). Being fully aware that the stabilized exchange rates are in the present phase commercial equilibrium rates, it must be stressed that - in particular in Poland's case - they are very distant from a rate reflecting the purchasing power parity (PPP) of the domestic money. The long-term process of equating these exchange rate levels - this process being indispensable in view of the efforts towards integration with the European and global economy - can threaten with a recurrence of inflationary processes and repeated economic destabilization.

¹⁸ In January-July of 1990 (against the same period of previous year) the industrial real output has declined by 28.7%, of which fuel and energy industry by 20.1%, metalurgy by 22.1%, but light and food processing industries by as much as 40.5% and 35.4% respectively.

¹⁹ It is evident that the general development level also exerts an influence on the course of the inflation and stabilization processes. In Viet Nam this level is exceptionally low; the per capita GDP amounts to about USD 160 (according to World Bank estimates). According to the same source, in Poland the per capita income (GDP) amounted in 1988 to USD 1,930 and Yugoslavia to USD 2,480, i.e. by 28 percent more. It can be easily calculated that as a result of recessions accompanying the stabilization this difference will grow to about 50 percent to Poland's disadvantage. The above data is controversial. For example, according to CIA estimates, in 1989 GDP per capita was USD 5,464 in Yugoslavia and to USD 4,565 in Poland from which, however, 40 percent should be deducted on account of the very low production quality (see - Europe, 1990.05.28 p.3).

References

Cagan, D. (1956), *The Monetary Dynamics of Hyperinflation*. In: *Studies in the Quantity Theory of Money*, ed. M. Friedman, University of Chicago Press, Chicago

Dornbusch, R. (1990), *Experience with Extreme Monetary Instability*, MIT, Cambridge, Mass., paper presented at the EDI-World Bank Senior Policy Seminar for European Countries on "Managing Inflation in Socialist Economies", held at IIASA, Laxenberg (Austria) on 6-8 March

Europe (1990.05.29), *Eastern Europe: Long Road Ahead to Economic Well-Being*, (1990) CIA Report, Washington, D.C., May

Goetz-Kozierkiewicz, D. Kolodko, G.W. (1990), *Stabilization in Viet Nam*, Institute of Finance, Warsaw

Working Papers No 12

Inflation, (1988), *Inflation Stabilization. The Experience of Israel, Argentina, Brazil, Bolivia and Mexico*, ed. Bruno, M. Di Tella, G. Dornbusch, R. Fisher S. MIT Press, Cambridge, Mass.

Kolodko, G.W. (1989), *Reform, Stabilization Policies and Economic Adjustment in Poland*, World Institute for Development Economics Research, Helsinki

WIDER Working Papers, WP 51

----- (1990a), *Crisis, Adjustment and Growth in Socialist Economy. Political Challenges and the Dilemmas of Economic Sciences*, Institute of Finance, Warsaw

Working Papers No 7

----- (1990b), *Polish Hyperinflation and Stabilization 1989-1990*, Institute of Finance, Warsaw (forthcoming in *Economics of Planning*).

Working Papers No 10

----- (1987), *Polska w świecie inflacji (Poland and the Worldwide Inflation)*, Książka i Wiedza, Warszawa

Kornai, J. (1990), *The Road to a Free Economy*, Norton, New York

Malecki, W. Kolodko, G.W. (1990), *The Indebtedness of East European Countries*, paper presented at the WSBM-ECPD Round Table on "Regaining and Further Enhancing Development Momentum in the Context of Rapid Global Change", held at Sveti Stefan (Yugoslavia) on 28-30 June

Nuti, D.M. (1986), *Hidden and Repressed Inflation in Soviet-Type Economies: Definitions, Measurements and Stabilization*, *Contribution to Political Economy* No. 5, 37-82

Nuti, D.M. (1990a), *Stabilisation and Sequencing in the Reform of Socialist Economies*, paper presented at the EDI-World Bank Senior Policy Seminar for European Countries on "Managing Inflation in Socialist Economies", held at IIASA, Laxenberg (Austria) on 6-8 March

Nuti, M.D. (1990b), *Crisis, Reform and Stabilisation in Central Eastern Europe: Prospects and Western Response*. In: *Eastern Europe: The Transition*, ed. J.P.Fitoussi, Paris (forthcoming).

