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Socialism, Capitalism, Transformation

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The Political Economy of Economic Reform: Poland, 1989–92

The Historical Background

After the Second World War Poland fell under Soviet domination, with two resulting fundamental changes in its institutional system: first, the establishment of an authoritarian political system of a party–state type centred around the Polish United Workers Party (PUWP), and second, the replacement of private property and the market by central planning and state ownership. One major exception to state ownership was agriculture, which after the attempt at forced collectivization in the first half of the 1950s remained largely private.

The centralized economy of Poland, similar to that of other socialist countries, initially grew fast, thanks to the very low point from which it started and very high rates of investment. However, as time went on, the efficiency of investment and of the economy as a whole continuously declined because of the decreasing ability of the centralized economic system to cope with progressively more complex economic problems. As the efficiency of investment declined, there was a tendency to try to compensate for it by increasing the rate of investment. This in turn increased the complexity of the economy, and so on. The overall result of this vicious circle was declining rates of growth of national income

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and almost stagnant consumption, already witnessed as early as the late 1960s.

Against this background, there was a forced change of political leadership in 1970 after the brutally suppressed protests in Gdańsk. The new leadership under Edward Gierek promised an improvement in the standard of living. The key to it, as it turned out, was massive foreign borrowing, which partly financed increased consumption and partly new investments in Western technology. The underlying assumption was that these investments would increase Poland's export potential to such an extent that the country would be able to service the debt and still achieve a higher level of GDP and consumption. However, this did not happen. The foreign borrowing proved excessive, and the related investments on the whole proved misdirected and inefficient, largely because they were undertaken within the framework of a basically unchanged centralized economic system. After rapid growth of the national income and consumption in 1971–78, Poland entered a long period of economic crisis with a huge and growing foreign debt. The drastic cuts in imports, due to the balance of payments difficulties, had brought about a decline in net material product of 27 per cent between 1978 and 1982.

An extraordinary change in Poland's sociopolitical system then occurred: after a wave of massive strikes in August 1980, the authorities agreed to the creation of an independent trade union, Solidarity. This ran against the basic rule of the communist system, that there are no organizations independent from the party–state. Trade unions in this system served as 'transmission belts' from the party to the masses. The form of a trade union was chosen largely because the leaders of the opposition rightly considered the proper organization – that of an opposition political party – totally unacceptable in the then-existing geopolitical situation. But Solidarity was a trade union only in name; in fact, it was a massive political movement for reform, which at its peak had 10 million members out of an adult population of 21 million. Despite this size, the presence of a common opponent – the authorities – and the common danger – Soviet invasion – produced a remarkable degree of unity and explained the self-limiting nature of Solidarity's demands, which may appear modest from today's perspective. In the area of economics, the principal demand was to replace central planning with market mechanisms without, however, privatizing the state enterprises.

The period of uneasy coexistence between Solidarity and the Communists ended with the introduction of martial law in December 1981 by General Wojciech Jaruzelski. The role of Soviet pressure is undoubted, although historians might quarrel about how large the risk of Soviet invasion was in the absence of the repressive measures the Polish authorities themselves took.

Solidarity was first suspended and then declared illegal. It continued, however, to work underground. The authorities launched an economic reform in 1982. It was even more modest than the one officially envisaged in 1980–81, and it preserved, among other things, a large measure of central allocation of inputs and the bureaucratic organizational structures necessary to operate such a mechanism. The authorities heavily relied on the increased output of coal, achieved by a radical strengthening of incentives for miners to work on Saturdays. This raised the relative wages of miners, the single most powerful industrial group, with about 450,000 people in 1985.

The autonomy of the state enterprises was, however, increased, and the workers councils, introduced in the second half of 1981, were gradually restored. Limited in scope and heir to many economic burdens, the reform failed to improve the performance of the economy.[1] In this respect, it was not much different from the slightly more radical Hungarian economic reform.

Amongst the growing economic and social tensions, 1988 emerged as the initial year of accelerated change, as it turned out, in the final period of Communist rule in Poland. The last Party-dominated government of Mieczyslaw Rakowski, formed in October 1988, introduced substantial economic liberalization with respect to the private sector and foreign trade. This was, however, accompanied by very lax macroeconomic policy, accommodating the growing wage pressures. As a result, both inflation and shortages caused by price controls increased rapidly. In February and March 1989 the 'Round Table' negotiations between Solidarity, led by Lech Wałęsa, and the authorities took place and culminated in an agreement signed on 5 April and approved by the Party-dominated Parliament a few days later. The agreement provided for political liberalization, including the legalization of Solidarity and other independent associations and quasi-free elections.[2] The results for the economy were rather mixed. The private sector was to be given equal rights to develop, but there was no mention of privatizing the state enterprises. Besides, the opposition managed to get approval for indexation of wages[3] and many wage and social benefits for the largest social

[1] This reform is discussed in the previous chapter.

[2] The elections were totally free for the newly created Senate, but crucial for the Sejm; that is, Solidarity was permitted to contend for only 35 per cent of the seats.

[3] The wages had to be increased by 80 per cent of the price increases in the preceding quarter in excess of normal, spontaneous wage increases.

groups.[4] This was partially due to the 'trade-unionist' nature of the opposition's economic negotiators and advisers, to the still-perceived political constraints, and probably to the conviction that it would be up to the government to implement these concessions. Another reason was the lack of overall coordination of the negotiations.

The results of the June elections surprised both sides. The Party suffered a crushing defeat, and Solidarity scored an unexpected victory. As a part of the political compromise, General Wojciech Jaruzelski was elected by the new Parliament to a newly formed post of president of Poland. His designated prime minister and closest ally, the former Minister of Interior Czeslaw Kiszczak, failed, however, in forming a government. After two months of hesitation, Solidarity decided to take the responsibility for the government by creating a coalition with two parties that used to be the junior parties of the PUWP. This government, led by Tadeusz Mazowiecki, was formed between 24 August and 12 September 1989. The author, after short but strong hesitation, accepted the dual job of deputy prime minister, responsible for the economy, and of finance minister.

Initial Conditions in 1989

The inherited economic conditions are described at greater length in the next chapter. Let us only note here that they included: the state-dominated and heavily distorted economic system; an economic structure burdened by a heavy dependence on the Soviet market for exports in such sectors as machinery, textiles, electronics, and pharmaceuticals and shaped during many years of import substitution; a large foreign debt.

However, the most important specific feature of the initial Polish economic situation was the dramatic state of the macroeconomy. Wages in the first quarter of 1989 were 120 per cent higher than a year earlier. However, the real explosion happened in the following months. The growth of wages quickened, followed by the increase in prices. Sharp increases in the state purchase prices of agricultural products and the

[4] The largest groups – miners, railways workers, farmers – had their own negotiation groups, which acted only in weak coordination. The representatives of these groups usually pressured for commitments that wages in their respective sectors be, for example, 200 per cent of the average wage in the economy. (Farmers demanded equivalently high guaranteed prices.) All these concessions were scrapped when the radical economic programme was launched, but they were a source of conflict with the respective groups.

continued controls of the consumer prices of foodstuffs produced an explosive budget deficit, increasingly financed by the creation of money. In this situation, after the freeing of food prices in August 1989, consumer prices jumped in that month by 40 per cent and wages by 90 per cent. The free market rate of exchange in early September 1989 was eight times the official one. Poland was entering hyperinflation, accompanied by massive shortages. There was also a heavy burden of foreign debt.

The sociopolitical conditions prevailing in Poland at the start of economic reform were rather peculiar. There was a sense of a newly gained freedom, but there was no euphoria because the economy was in bad shape and there was still some uncertainty with respect to the Soviet Union. Solidarity achieved an unexpectedly great victory, and the Communist Party was, on the whole, ready to cooperate. But there were some more radical opposition groups, which did not participate in the Round Table discussions. Some of them later became more and more active, accusing the participants of a conspiratory deal with the Communists and propagating an extremely populist economic programme.

Solidarity, with its idealistic ethos of a movement for the general good, was again legal and expanding, and was strongly represented in the Parliament. It was widely expected that Solidarity would provide an umbrella for the economic reforms. However, helped by hindsight, one remembers that Solidarity was united mainly by the presence of the common opponent: the Soviet Union and the Communist Party. There was no elaborated, shared positive programme of how to organize the political and economic life after communism, and once these unifying elements disappeared, splits were inevitable.

There was also a peculiar social structure from the point of view of the transition to a capitalist market economy. The numerically largest group – the industrial workers – was the product of socialist industrialization; paradoxically, it was they who organized the strikes, supported and co-organized by intellectuals from the opposition, and undermined socialism. This gave the workers (and this was probably partly their own perception) a kind of romantic aura, superimposed upon the Marxist propaganda of the proletariat as the avant-garde. The Solidarity period also enshrined and popularized various forms of workers' protests, even hunger strikes, usually accompanied by a display of the national flag. These were the workers who had to face the negative consequences of the transition to a market economy, the first being actual or potential unemployment.

Another large social group, the farmers, were generally considered, and likewise considered themselves, as the preservers of private property. The average size of the 2.7 million private farms was only 7.2 hectares, and 30 per cent of the farmers had less than 2 hectares (they usually had the status of farmer-workers). They had functioned for many years in a nonmarket environment characterized by a mixture of discrimination and tutelage from the state. The former consisted mainly of much lower administrative allocations of inputs compared with those obtained by the state farms and restrictions on enlarging the size of private farms. The latter took the form of subsidized credits and guaranteed purchases of agricultural products by the parastatal organizations. Moreover, in 1989 the farmers achieved large windfall gains, thanks to the freeing of the prices of foodstuffs by the last Communist government. Also, the hyperinflation in 1989 practically eliminated the real burden of taxation of the farmers, which was low in any case. The complementary liberalization of the prices of inputs to agriculture to be introduced in 1990 and the adjustment of tax rates took these windfall gains away from them. This sequence was politically unfortunate, but it was unavoidable because of the initial conditions in the country.

The existing interest groups were relatively strong on the labour side, which included the trade union Solidarity and its main rival, the Polish Confederation of the Trade Unions (OPZZ), which was organized after the introduction of martial law and the proscription of Solidarity. By contrast, the employers' organizations were very weak, and the same was true of the consumers' movement. There were several organizations fighting for influence among the farmers, both former allies of the PUWP and linked to Solidarity.

The Economic Strategy: Concept and Launching

This strategy was elaborated during late 1989 and it was launched, as a comprehensive package, in early 1990. While we were working on the comprehensive economic programme, we also took measures aimed at coping with the current situation in such a way as to prepare the ground for the decisive operation in 1990. For example, there had been a series of devaluations preceding the unification of the exchange rate in 1990, interest rates were increased, and the wasteful system of subsidizing coal mining was replaced by a more rational one. Also, the excessive indexation of wages was abolished, and a much more modest system was introduced, to be replaced by a tough wage restraint in early 1990. Two successive budgets for the remaining part of 1989 were prepared. All this was done while negotiating with the International Monetary

Fund (IMF) and lobbying the Western governments for a $1 billion stabilization fund.

The development of the economic strategy is described at greater length in the next chapter. Here I would note that the peculiar feature of the Polish economic programme (and later that of other programmes in the post-socialist countries) was that, in view of the initial economic system, the systemic transformation had to be far more comprehensive and radical than in any previous cases of market-oriented reform. Another characteristic of the Polish programme was that the systemic change had to be combined with radical economic stabilization because of inherited hyperinflation and massive shortages. This distinguished the Polish situation from that of Czechoslovakia and Hungary, which were macroeconomically much more stable, and made it similar to the situation in some Latin American countries and to the initial conditions in the former Soviet Union as well as Bulgaria, Romania and Albania two years later.

The Polish economic programme had, since its earliest incarnation, devoted special attention to dealing with the foreign debt.[5] The goal here was to achieve a radical debt reduction, in the first place from the official creditors (who hold about two-thirds of the total debt). We assumed that the pioneering role of Poland in the political transformation of Eastern Europe and the radical nature of its economic programme made such a goal realistic. The debt reduction was viewed in turn as a factor that increased the chances for success of economic stabilization and transformation.

Political acceptance of the radical economic programme required special mobilization on the part of the government's economic team. In the second half of November 1989, the team set up a special task force to coordinate the preparation of the final version of the basic eleven laws and related regulations. After a series of consultations in parliament, I obtained approval of the idea by a special all-party parliamentary commission to work on the government's draft laws. This enabled a radical acceleration of the legislative process to take place, as compared with the normal procedure of sequential discussion of draft laws by several parliamentary commissions. A similar special commission was set up in the Senate, which normally would discuss the draft laws only after they had been accepted by the Lower House (the Sejm). But this time the Senate's commission agreed to work in parallel with the Sejm.

The draft laws prepared by the special working groups were first

[5] Jeffrey Sachs was especially helpful in working out this part and in presenting the Polish case to the Western public.

discussed by the Economic Committee of the Council of Ministers, of which I was chairman. These discussions went quite smoothly.[6] Then, the laws were submitted to the entire Council of Ministers. All this happened in the first half of December 1989. Given the amount of the proposed legislation and the time pressure, these debates had some dramatic moments.[7] But all of the draft laws and the budget for 1989 were accepted before the agreed deadline for the opening of the parliamentary debate, 17 December, which happened to be a Sunday. This speed underscored the extraordinary nature of the whole undertaking and gave some additional drama to my introductory speech on behalf of the government.

The special commissions of the Sejm and the Senate worked extremely intensively and in close collaboration with the government's experts. Any attempted major deviation from the government's proposals was quickly reported, and the economic team intervened. The legislative package was adopted by the Sejm on 27 December and two days later by the Senate, in both cases by a very wide margin. Just before the end of 1989, the package was signed by President Wojciech Jaruzelski, and it became law. The major legislative phase was over.

The Developments of 1990–92

In early 1990 a radical, comprehensive stabilization–liberalization programme was launched. Initial inflation turned out to be higher than expected and the fall in output deeper. Open unemployment started to emerge. But the inflation rate quickly started to go down,[8] and shortages and queues rapidly disappeared. The supply of goods improved dramatically. The newly convertible zloty held stronger than expected. Exports to the West surged.

[6] Some of the sessions of the Economic Committee in December 1989 were chaired (while I was negotiating with the IMF mission or conducting political consultations) by Deputy Prime Minister Jan Janowski, who came from the party that used to be a junior partner of the PUWP and represented artisans and small entrepreneurs. Janowski turned out to be a close ally of the economic team during his service in the Mazowiecki government.

[7] An important role in these crucial moments was played by Waldemar Kuczynski, an economist who acted as the chief adviser to Prime Minister Tadeusz Mazowiecki and supported the radical economic program.

[8] It was almost 80 per cent in January, 23.8 per cent in February, 4.3 per cent in March, 1.8 per cent in August, but then it increased to 4.6 per cent in September.

On the institutional front, in May 1990 there were elections to new, genuine local governments, and in July 1990 the parliament passed, after five months of deliberations, a comprehensive law on the privatization of state enterprises. Meanwhile, privatization of shops and restaurants (so-called 'small privatization') was proceeding very quickly. Other important laws were passed, too, such as a law disbanding the compulsory 'quasi-statist' associations of cooperatives, a law on insurance, an anti-monopoly law, a telecommunications law, a bankruptcy law, a law abolishing some 50 extrabudgetary funds, and a social safety law.

On the social and political front, after the initial calm between January and April 1990, the situation started to get more complicated. At the congress of Solidarity in April, many delegates were very critical of the economic programme. In June, farmers blocked important roads demanding measures that would enable the dairies (formally farmer cooperatives) to pay higher milk prices. The government ordered the police to unblock the roads, provoking furious attacks in Parliament from the deputies of the peasant parties.

But most importantly, deeper and deeper splits appeared in the Solidarity movement itself. They were largely related to the growing conflict between its leader, Lech Wałęsa, and then-Prime Minister Tadeusz Mazowiecki. Wałęsa accused his opponent of being too slow in effecting political change but, on the whole, he refrained from criticizing the economic reform. In May 1990 Lech Wałęsa declared his intention to become the president of Poland, a post still occupied by Wojciech Jazuzelski. The conflict culminated in the open split in the Solidarity movement into two camps: one supporting Lech Wałęsa and the other Tadeusz Mazowiecki. In the election campaign, which dominated the mass media in the autumn of 1990, the economic programme came under attack from the three non-Solidarity candidates. The most demagogic critic, Stanislaw Tymiński, a Polish émigré not quite faithfully representing himself to the Polish public as a successful Western businessman who knew how to turn the Polish economy into a thriving business quickly, unexpectedly won second place. Wałęsa was first, and Mazowiecki, who was third, resigned together with his government.

The year of 1990 ended, therefore, in a complicated political situation. In the economy, after the rapid decline from 80 per cent in January to below 2 per cent in August, the inflation rate increased to between 4 and 5 per cent monthly in the second half of the year. This was due to increased wage pressure, stimulated by the overall political climate, and to the monetary policy, prematurely relaxed during the summer. (It was tightened in the autumn of 1990.) But the budgetary situation during the year as a whole was better than expected: foreign reserves more than doubled, exports to the West increased by 43 per cent, the shops changed beyond recognition, and privatization of the smaller units, especially in trade and services, rapidly advanced. Unemployment stood at over 6.1 per cent, and the official statistics registered a substantial decline in GDP.

In early 1991 a new government led by Jan Krzysztof Bielecki was formed; the author continued as a deputy prime minister and minister of finance with overall responsibility for the economy. The year started with massive attacks by the trade unions on the wage controls. But after tough negotiations, the government did not give any significant concessions. Private enterprises, including the privatized ones, were released from wage controls altogether by the revised law of December 1990 on the assumption that the self-interest of private owners would prevent excessive wage increases. But this fuelled accusations from the state enterprises that they were discriminated against by a 'doctrinaire' liberal government keen on 'destroying the state sector'.

However, by far the largest source of problems in 1991 turned out to be the collapse of trade with the Soviet Union and the terms of trade losses due to the move to world prices and hard currency payments. This was mostly responsible for the higher-than-expected inflation in the first months of the year, the decline in output and falling profitability of state enterprises. The two latter factors, together with forecasting errors, made the budget for 1991 obsolete after a couple of months. In the revised budget, 80 per cent of the shortfall of the nominal revenues was made up by expenditure cuts and 20 per cent by an increased deficit. This drastic revision had to be formally confirmed by the Parliament just before parliamentary elections in October 1991.

The institutional reform in 1991 included, among other things, a new securities law and establishment of the stock exchange, a new liberal foreign investment law, a law on a comprehensive personal income tax, and a law on fiscal policy. The new import tariff was introduced in August 1991 with a higher average rate, but it was more uniform and in line with the EEC classifications.

Privatization of larger state enterprises was slow, but the autonomous growth of the private sector was extremely fast and the privatization of smaller units and of assets of state enterprises rather rapid. As a result the value added generated in the private sector increased in 1991 by 33.3 per cent, and this growth occurred across the economy: in manufacturing by 42.2 per cent, in construction 64.0 per cent, in domestic trade 61.7 per cent, agriculture 10.2 per cent. In contrast, the GDP produced in the public sectors declined by 26.3 per cent (*Rzeczpospolita*, 2 December 1992, III).

In May 1991 the zloty was devalued by 14 per cent after sixteen months of a fixed exchange rate and pegged to a basket of currencies, instead of the previous peg to the dollar. In October a crawling peg was introduced with a monthly devaluation of 1.8 per cent.

In April 1991 Poland signed an unprecedented agreement with the Paris Club, whereby 50 per cent of the official debt (two-thirds of the total Polish debt) would be reduced in two stages.

The parliamentary elections in October were preceded by two months of campaigning in which sixty-five political parties took part. Most of them were very critical of the government's economic programme and presented radically different proposals. To the extent their economic programmes were defined at all, they usually included relaxation of monetary and fiscal policy, increased protectionism, and more active involvement of the state bureaucracy in the affairs of specific industries and enterprises. The elections produced a very fragmented parliament, composed of almost thirty political groups. As a result, a coalition of five to seven parties was required to form the government. The new government of Jan Olszewski was formed at the end of December 1991, after over two months of intensive negotiations. (The author ended his public service in December 1991.)

The new government started claiming a sharp break with the past but gradually toned down its revisionist declarations and basically continued the disciplined fiscal policy. But privatization of larger state enterprises was practically brought to a halt, and political debate on privatization got more and more demagogic. The Polish zloty was devalued in February 1992 by 11.6 per cent.

In June 1992 the government collapsed after a clumsy attempt at disclosing the former regime's 'secret agents' in the state institutions, and, after more than a month, the new government of Hanna Suchocka was formed. The new government, based on a coalition of two clearly pro-reformist parties with a fundamentalist Catholic party and two small peasant parties, basically continued the programme started three years before: i.e., it tried to strengthen macroeconomic stabilization, to maintain the liberal character of the economic system, and to speed up privatization. The major changes were concessions to the farmers (promises of increased protectionism, one-time subsidies on fuel for the farmers following a severe draught) and a 'social pact' with the trade unions centred on modifying wage controls and on privatization. The government had to deal with a wave of strikes in December 1992, mainly in the coal mines. The strikes ended with an agreement, but its financial implications were not completely clear.

After three years, the Polish economy was macroeconomically much more stable and substantially transformed. The inflation rate, as measured by the consumer price index, had fallen from the annual rate of 2,000 per cent in the second half of 1989 to 44.3 per cent in 1992. Producer prices in manufacturing increased by 31.3 per cent in 1992. Prices were freed, and therefore the price structure was fundamentally improved; shortages and queues disappeared, and the supply of goods was incomparably better than three years before. The private sector employed 60 per cent of the labour force and generated 50 per cent of the GDP, by far the highest ratios in the post-socialist countries. Thanks to the continuous rapid growth of the private sector across the economy and to the improved performance of some state firms during 1992, Poland was the first post-socialist country where GDP stopped falling. As a matter of fact, it is estimated to grow at a rate of between 0.5 and 2 per cent. The official GDP figures showed a cumulative drop in 1990–91 of 18 per cent, but unofficial estimates put it in the range of 5 to 10 per cent.[9] Both exports and imports increased rapidly, which sharply raised their share in the GDP. This happened despite the collapse of trade with the Council of Mutual Economic Assistance (CMEA). Foreign reserves almost doubled.

But some serious problems remained. Unemployment increased from practically zero in early 1990 to 13.6 per cent at the end of 1992. Heavy industry and coal mining required unpopular restructuring. The budget deficit had to be contained, which demanded, first of all, measures aimed at reducing the growth of subsidies to the pension system. The liberal foreign trade regime was under attack from the farmers' lobby, and rapid, unconventional privatization of state enterprises, based on free distribution of shares, was delayed for a year and half because of the elections and the political conflicts in the Parliament. All in all, maintaining macroeconomic stability and completing the transition to capitalism largely depended on a rather fragmented political system. But the economy was much more independent of the political scene, and despite the fragmentation of Parliament, a tough budget for 1993 was passed in February 1993.

[9] These estimates were made at the Research Institute of the Main Statistical Office and the Polish Academy of Sciences (Rajewski 1992, pp. 133–40).

Lessons from the Polish Experience

CIRCUMSTANCES LEADING TO THE LAUNCH OF THE ECONOMIC PROGRAMME

The Polish programme was prepared and launched under a double crisis: a long-term structural problem of low and falling efficiency and a macroeconomic catastrophe. It was the latter that gave the Polish situation a dramatic dimension. This crisis both required radical measures, especially with respect to stabilization, and increased the people's readiness to accept such measures. But there was an important complement: the newly gained external freedom due to the collapse of the Soviet bloc. Otherwise, the radical institutional programme, especially privatization, would not have been possible. Liberalization and a massive Solidarity victory probably motivated people to accept the radical reforms. In the special situation of 'extraordinary politics', there was a stronger-than-usual tendency among the political actors to act in terms of the common good. This and the government's speed of action explain the overwhelming acceptance of the economic programme.

The special motivation of the people at large would not have lasted very long and was probably cut short by the growing conflict within Solidarity and the rather unpleasant way in which it split in 1990. Indeed, people for whom Solidarity represented an idealistic movement for the common good might have felt cheated and thus were willing to look elsewhere to invest their political sympathies. This and the related presidential elections in the autumn of 1990 certainly shortened the honeymoon period.

Poland in 1989 cannot be regarded as a testing ground for a rival hypothesis that 'the scope for reforms would be greater where an incoming government won a mandate for change by the substance of its preceding election campaign, rather than where it surprised its supporters after winning power' (Williamson 1992). For Solidarity at the Round Table represented, rather, 'trade unionist' demands, and it did not expect then nor during the election campaign that it would be forming the government in 1989. Certainly, Solidarity did not present anything that resembled the radical stabilization–transformation programme launched half a year later. This shift might be explained by the changed macroeconomic situation (price eruption in August 1989) and by the fact that the government's economic team was composed of people not present at the Round Table who had a critical view of the economic part of the agreement reached there. A different composition would probably have meant a different – most likely less radical – economic programme.

Given these circumstances, notably the 'third-way' elements in the Solidarity tradition and the speed with which the programme was launched, the Polish public could not have been psychologically well-prepared for the radical economic measures. It is however, highly doubtful whether the delay would have brought about much more understanding, and it definitely would have worsened the macroeconomic situation.

As to the opposition in Parliament, it formally consisted of the PUWP. But because it partly comprised disguised (or open) liberals and because there was a general atmosphere of national unity in late 1989 and the PUWP had suffered a crushing defeat in June 1989, it did not seriously challenge the programme. There was much more opposition from the United Peasant Party, formally a coalition partner. In general, the distinction between the ruling parties and the opposition was not very pronounced, as far as the attitude towards the economic programme was concerned. And although the parliamentary debates on the economy got more and more critical over time, until August 1991 (just before parliamentary elections) it was possible to persuade Parliament to adopt all the major economic legislation proposed by the government and to block any initiatives that would constitute a major deviation from the government's economic programme.

THE ECONOMIC TEAM

An economic team with coherent views was an important factor in the Polish case. Here, I think I have to say a few words about myself. In August 1989 I still did not imagine for a second that I might be responsible for free Poland's stabilization–transformation economic programme. But I had worked for almost fifteen years on economic reform and institutional issues,[10] and in a paper written in April 1989 for a conference in Poland, I sketched out what I thought were the necessary elements of a radical and comprehensive economic package for Poland: price liberalization, convertibility of the Polish zloty, tough macroeconomic policy, privatization. In 1978 I formed a group of ten young economists to work on economic reform. After August 1980, our work was given much publicity, and the group was often called the

[10] This included the study of the South Korean economy I made as a visiting fellow at the Institute of Development Studies at the University of Sussex in 1985 and the research of Ludwig Erhard's reform, which I made in Germany in 1988.

'Balcerowicz group'. (It was probably because of this that I was offered the position in the government nine years later.) After the introduction of martial law in December 1981, the group's members and some sympathizers continued to meet at my institute for seminars to discuss various problems of the economic system, including the importance of property rights and privatization. When I accepted the job in Mazowiecki's government, it was agreed that I would be responsible for the makeup of the economic team (with Mazowiecki's final approval, of course). This applied without caveats to my deputies in the Ministry of Finance and also to the main economic ministries. This was also true of the formation of the second government in early 1991.

In 1989 some of the members of the 'Balcerowicz group' or other participants of the seminar became my closest associates.[11] Besides, I happened to know personally from my student days at the Central School of Planning and Statistics (now once again the Warsaw School of Economics) some of the people who were already in high positions in the Ministry of Finance and remembered them as capable and energetic individuals.[12]

The shared background, commonality of purpose, similar age (around 40), and the common pressures created what quickly became known as the 'Balcerowicz team'. This applied, first of all, to the deputies in the Ministry of Finance who had to defend the tough economic measures within the government structures, in Parliament, and against the public. An important intellectual support was offered by some advisers.[13]

Throughout my service in the government, there had been good cooperation with the central bank, headed in 1989–90 by Władysław Baka and in 1991 by Grzegorz Wojtowicz. This seems to be a sharp contrast with the situation in Russia in 1992. More generally, issues

[11] For example, Marek Dąbrowski, who was my deputy in the Ministry of Finance until the summer of 1990, and Stefan Kawalec, who was first my chief adviser and then my deputy in the same ministry, responsible for financial institutions.

[12] This applied to Janusz Sawicki, my deputy at the Ministry of Finance, responsible for foreign debt negotiation, and Andrzej Podsiadło, who was overseeing the state enterprises in the Ministry. Grzegorz Wójtowicz, first deputy chairman of the Polish National Bank and its Chairman in 1991, graduated the same student year in my faculty of Foreign Trade of the Central School of Planning and Statistics. Wojciech Misiąg and Ryszard Pazura, my other two deputies in the Ministry of Finance, also graduated from the Central School of Planning and Statistics.

[13] This group included both foreign advisers – Jeffrey Sachs and David Lipton, Władysław Brzeski, Stanislaw Gomulka, Jacek Rostowski and Stanislaw Welisz – and Polish ones: Karol Lutkowski, Andrzej Stanisław Bratkowski, Antoni Kantecki, Adam Lipowski, Andrzej Parkoła and Andrzej Ochocki. Most of the foreign advisers were of Polish origin.

related to the central bank and its relationships to the government's economic team are important in the context of radical stabilization–transformation programmes.

It was also of importance that as a deputy prime minister I was chairing the sessions of the Economic Committee of the Council of Ministers, which comprised economic ministers and chiefs of other economic agencies (including the governor of the central bank). The committee acted as a vehicle for coordination and the preparations of decisions to be taken by the Council of Ministers.[14]

As deputy prime minister I had created a special section of overall coordination that focused on political aspects of the economic programme – that is, contacts with the respective political parties, with the Parliament and with the mass media. This section was directed by Jerzy Koźminski, who used to be one of my best students of international economics. He played an important role in devising and sustaining political support for the economic programme, as well as its overall coordination, especially in the crucial moments of December 1989.

Political Leadership and Economic Reform

The relationship of political leadership to economic reform was not clear because the issue of political leadership itself was not completely clear. In late 1989 and the first months of 1990, Lech Wałęsa, leader of the victorious Solidarity, stayed in the background in Gdansk, and the prime minister, Tadeusz Mazowiecki, became the most popular Polish politician (he reached popularity ratings of over 80 per cent). Mazowiecki, a man of deep principles, certainly had a vision of history. (Elections at that time were in any case not in sight.) But for a number of reasons, the programme was not identified with him but was known already in October 1989 as the 'Balcerowicz programme'. One of the reasons was the tacit agreement that I would take overall responsibility for the economy.[15] Another reason might have been the speed with which the economic programme was launched and the visible role the economic team played in it. The economic team thus assumed an important political role.

Since May 1990, there had been a growing conflict within Solidarity, mostly on noneconomic and personal grounds. I tried and largely managed to keep the economic programme outside this dispute. Wałęsa himself declared in his short presidential address in December 1990 that

14 The secretary of this committee was Alfred Bieć, one of my closest associates.

15 During my first meeting with Mazowiecki, he said he was looking 'for his Ludwig Erhard'.

he would 'support the Balcerowicz programme', and he largely kept his word.

The new government formed in January 1991 displayed similar composition and orientation with respect to Poland's economic problems, and new Prime Minister Jan Krzysztof Bielecki, an economist by profession and one of the leaders of the Liberal Party, was courageously defending the tough economic programme. But the political situation grew more and more complicated, especially after August 1991, when the coming parliamentary elections dominated the political scene. The election campaign was dominated by ever more virulent attacks on the economic programme, and in the new, fragmented Parliament, formed in November 1991, groups opposing the programme had a stronger representation than in the previous one.

The issue of the political leadership's attitude towards the previous economic programme became almost schizophrenic under the third government, headed by Jan Olszewski. He and some of his ministers were very critical of this programme and came to power under the heading of 'breakthrough' – that is, a radically different strategy. But with respect to fiscal policy, they largely continued the previous line.[16]

The situation became much clearer under the government of Hanna Suchocka, since both she and some of her ministers are representing the reform parties that participated in the first or in the second government. The fact that the new forces of development turned out in 1992 to be stronger than declining tendencies also made it easier to identify in public with the economic programme started three years before.

Dynamics of Political and Economic Reform

The economic strategy in Poland was based mostly on economic principles but was supplemented by some psychological and political constraints. The economic rationale behind the radical economic programme has already been discussed: hyperinflation and massive shortages called for

[16] This government started operation at the end of December 1991, when a tough provisional budget for the first quarter of 1992 and some other accompanying laws, prepared by the previous government under my direction, were already in Parliament. The Olszewski government upheld these laws and the budget, claiming that they did not like them but that they had inherited them. Later, probably better understanding the constraints and thanks to Minister of Finance Andrzej Olechowski, the Olszewski government prepared a tough budget for the entire year. Another reason for this continuity was also that the budget department in the Ministry of Finance had been directed since September 1989 by the same person, Deputy Minister Wojciech Misiąg.

tough stabilization measures, the previous unsuccessful attempts at partial reform spoke in favour of launching a comprehensive and radical transformation programme, and so on. But I also remembered from Leon Festinger's (1957) psychological theory of cognitive dissonance that people are more likely to adapt internally to quick, radical changes in their situations if they consider them irreversible than they are to adapt to gradual changes. Finally, I also sensed that the period of 'extraordinary' politics was short-lived and that one should use it to introduce tough economic measures. The full significance of that became obvious only in the second half of 1990 when the political situation deteriorated considerably.

The timing of political events, including the elections, was not planned in advance by any strategic centre because of the conflicts and lack of efficient communication among Solidarity elites. For economic policy-making, the elections were a given – not fully known in advance and, clearly, not with a fortunate outcome. The two successive election campaigns in the first and the second year of implementation of a tough economic programme probably magnified public discontent and certainly contributed to wage pressure and to a slowing in state enterprises' adjustment to the realities of the market economy. In this respect, a contrast can be drawn between Poland and Hungary where, after free elections in early 1990, the next elections were held in 1994. The change of Parliament and even more frequent changes in the ministerial positions have slowed down some important reforms, especially the mass privatization of larger enterprises.

But given the unplanned and uncontrollable sequence of political events and the equally uncontrollable external shocks, it is highly doubtful whether there could have been a radically different economic strategy that would have made more economic sense and would have been politically more acceptable. The main reason for the success of the Polish economic reform seems to be the great speed of its early phase, when fundamentals of a liberal economic system and macroeconomic stability were established. It was easier for the supporters of the market-oriented reforms to defend them as *fait accompli* than it would have been to build reforms gradually in the face of strong populist opposition in Parliament after the elections of October 1991.

Besides this general explanation, there are related, more specific reasons for the sustainability of Polish economic reforms. One of them is the independence of the central bank, introduced as an element of the comprehensive reform package in December 1989 and strengthened in 1991. This independence has allowed the bank to act as a constraint upon an irresponsible budgetary policy. Another reason has been the convertibility of the currency for current account operations, another element of the first reform package. In the absence of convertibility, it would have been easier to engage in populist macroeconomic policies. In this respect, convertibility plays a similar role as a check upon government policies, as does export-oriented growth. Third, the rapid elimination of shortages in a country plagued by them for over forty years provided a strong, popular justification for free prices and, to some extent, for the overall economic programme. The disappearance of queues and the significantly wider range of goods available in the shops contributed the most important forms of popular compensation for the radical economic reform in its early phase.

The fourth reason for the sustainability of economic reform has been the growth of the private sector. True, the privatization of larger enterprises has been delayed for political reasons. But other processes of the overall privatization of the economy – the spontaneous growth of the private sector, small-scale privatization, and privatization of the assets of state enterprises – have been fast. As a result, the share of people employed in the private sector, outside the already largely private agricultural sector, increased from 13.2 per cent in 1989 to 34.4 per cent in 1992.[17] Surveys show that those employed in the private sector are typically much more in favour of the market-oriented reform than employees in the public sector. Privatization has, therefore, an important political dimension.

The failure to introduce mass, unconventional privatization in 1991 and in 1992 based on the free distribution of shares probably thus entailed some foregone gain in political support for market-oriented reform. But the introduction of this privatization could not have positively influenced the economic situation in these years because of the lags between privatization and the change in the economic performance of affected enterprises.

Communicating with the Public

There have been constant and justified complaints that the 'information policy' of the government – that is, the explanation and prediction of the consequences of economic change – was inadequate. There were a

[17] These figures refer to a narrow definition of the private sector that excludes cooperatives. On a broader definition, including the cooperatives, the share of the private sector outside agriculture increased from 31.2 per cent in 1989 to 44.4 in 1992 ('Informacja o sytuacji społeczno-gospodarczej kraju. Rok 1992.' *Główny Urząd Statystyczny*, 1993, p. 51). This shows that a part of the growth of the narrowly defined private sector came from the privatization of parastatal cooperatives.

number of reasons this was so. As far as policy-makers – including myself – were concerned, there was a perennial problem of how to divide the limited time between making economic policy and explaining it. Since the number of problems to be tackled was rather unusual, the time spent on the latter was clearly insufficient. I also found it psychologically and intellectually difficult to make firm predictions. I was reasonably sure of the direction of general developments but could not predict their exact timing and magnitude. But there was the constant demand to commit 'the fallacy of misplaced concreteness': to say when exactly things were going to get better, when the standard of living would rise. The economic reform was helped by the support of practically all the major national newspapers, which published articles and commentaries by a small group of very good economic journalists.

On the other hand, a number of factors served to counter attempts at explaining radical, market-oriented reform to the Polish public. Most of these factors could be regarded as by-products of the transition to democracy. First, in the newly freed mass media and especially in television, which was subjected to especially stringent political control under communism, there emerged a strong tendency to focus on the negative and the sensational. The same was true of most local newspapers. Part of the opposition press constantly presented various conspiracy theories as explanations for the economic difficulties.

Second, the decisive majority of Polish economists were very critical of the programme. This might have conveyed to the public the impression that Polish 'experts' were, on the whole, against the reforms. To some extent, this impression was probably counterbalanced, particularly in 1990, by the echoes of favourable Western opinion.

Third, and by far most important, there were two election campaigns in the first and second years of economic reform. Election campaigns nowadays always have elements of propaganda or psychological 'warfare', given the power of television and radio. This raises the interesting empirical question of how the election campaigns influence the economic views of the public. In Poland, especially in 1991, the media bombarded the Polish public with messages that the Polish economy had been struck by economic catastrophe and that there should be a radically new programme to improve the situation quickly. This proposed programme had three familiar elements: relaxation of monetary and fiscal policies, protectionism and state intervention at the industry level.

Fourth, under the previous regime there was a large apparatus for propaganda and information. The democratic revolution involved the abolition of this structure, and it took time to build a new government information structure to deal with the independent mass media and with the public at large.

External Influences

One should distinguish between external influences with respect to the content of the economic programme and those factors that affected internal support for the programme. In the Polish case, the latter was much more important than the former. In negotiations with the IMF, multilateral banks and Western governments, there was very little pressure with respect to economic strategy and its crucial details because the Polish programme was basically in line with the goals of these organizations.

Within the government and in parliamentary debates, I used conditionality only as additional argument in favour of the economic programme. In other words, I stressed that the programme was motivated by our internal considerations, but in addition, its implementation meant the support of the IMF (and of other international organizations), and this support was needed to make the programme internationally credible and to obtain sizeable debt reduction. This was not only truthful but also probably politically more effective than trying to push through tough measures on the pretext that the IMF had imposed them. This view of conditionality also helped recently to push through the tough budget for 1993. Of importance in increasing the support for the radical stabilization–liberalization package discussed in December 1989 was the prospect of obtaining the $1 billion stabilization fund. This was interpreted as a sign of the positive assessment of the programme by Western governments, and the fund increased the confidence of the reformers in the feasibility of convertibility of the Polish zloty. Without the stabilization fund, convertibility would not have been launched.

General Remarks

CHARACTERISTICS OF THE REFORMERS

Based on introspection and on observations, I cannot help but agree with John Williamson's assertion that there are policy-makers whose characteristics and actions are at sharp variance with the stylized, selfinterested politicians of public-choice theory. There are, in my view, two basic differences between 'technopols' and the stereotypical politician. First, his or her economic knowledge may give a 'technopol' – an economic technocrat in a position of political responsibility – a better picture of the available options and their economic and social consequences than is typically the case with career politicians. Second, there are motivational differences. One does not need to speak of altruism in the case of technopols (although it cannot be ruled out), but one may simply state that they attach different 'motivational weights' to economic options than do typical professional politicians. These differences may be partly caused by differences in perception: for example, technopols may more clearly see the danger of populist strategies than other politicians do. Another motivational characteristic is differences in the need for self-esteem. The self-esteem of a technopol suffers if his economic reform is implemented and then fails from an economic standpoint. His self-esteem would probably suffer less if reforms that could have been successful if implemented were socially or politically rejected, costing him a job. The self-esteem of a career politician suffers the most if he loses in the political game. It is also probably of importance that technopols have alternative careers (in the field of academia, business, international financial organizations), and their reputation in those fields depends on how they conducted economic reforms. A professional politician usually has to stick to politics, and abandoning politics may mean a life failure.

'EXTRAORDINARY' VERSUS 'NORMAL' POLITICS

I have used the concept of 'extraordinary politics' to describe the Polish situation in the second half of 1989 and early 1990. But this concept can be generalized to some other historical contexts. 'Extraordinary politics' by definition is a period of very clear discontinuity in a country's history. It could be a period of very deep economic crisis, of a breakdown of the previous institutional system, or of a liberation from external domination (or end of war). In Poland, all these three phenomena converged in 1989.

The new political structures, including political parties and interest groups, are fluid, and in a sense, there are usually no professional politicians during such a period. The older political elite is discredited, and the politicians representing the new order have not yet emerged or have not had enough time to become professional. Among the political elites and the population at large, there is a stronger-than-normal tendency to think and to act in terms of the common good.

In such a case, the period of extraordinary politics both calls for and creates especially favourable conditions for the emergence of technopols. There is no guarantee, though, that they will appear, for there is a large element of chance. Also, the countries that are in greatest need of domestic technopols, because of the past devastation (foreign technopols not usually being admitted to high government positions), are the least likely, because of this devastation, to find them. Depending largely upon whether technopols appear on the scene or not, the increased chances for extraordinary actions inherent in extraordinary politics are used or wasted.

Extraordinary politics is a short period and gives way to 'normal' politics: politics of political parties and of interest groups, a sharply reduced willingness to think and act for the common good, and stronger institutional constraints with respect to the individual political actors. In the period of extraordinary politics, these constraints are fluid or loosely defined.

During the time of normal politics, the appearance and the continued operation of technopols is much less likely than during extraordinary politics.

Public-choice theory, as positioned by James Buchanan and Gordon Tullock (1962) and others, is much more applicable to normal than to extraordinary politics. The main reasons for the latter's inapplicability are the high frequency of technopols reaching positions of power and the fluidity of institutional constraints.

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Transition to the Market Economy: The Polish Case, 1989–93

The process and outcome of any economic transition depend on (1) the initial conditions, (2) the transition strategy, and (3) the conditions prevailing during the process, which have an effect on it while being largely or entirely independent of the actual transition.

The next section discusses the initial condition, the following section the choice of economic strategy and the conditions for its implementation. Then we deal with the economic outcomes, and the final section deals with the main lessons learned. I concentrate on the economic aspects of Polish reform as I have discussed the political economy in the previous chapter.

Initial Conditions

There are at least five main categories of initial conditions which are especially relevant for the transition to a market economy: (1) the macroeconomic situation, (2) the economic system, (3) the structure of the real economy, (4) the net foreign debt, and (5) the level of human

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capital. We can characterize Poland's initial conditions in the middle of 1989 by identifying the state of affairs in each of these five categories and comparing them with the situation found in the other countries of Central and Eastern Europe in their pre-reform stage. This will allow us to determine what conditions were specific to Poland and what conditions were shared by other countries of the region.

Along with other socialist countries Poland had a special type of non-market economic system. This system was dominated by the state sector, characterized by heavy industrial concentration, accompanied by distorted prices due to massive price subsidies and controls, geared to import substitution and deprived of both internal and external competition. There was a regime of multiple exchange rates and the currency was not convertible. Institutions necessary for a market economy were absent, as capitalism had been destroyed and not merely suspended as in West Germany before 1948 or distorted as in Latin America. There was no genuine central bank, nor any true commercial banks, no stock exchange, no governments bonds to finance the budget deficit and no genuine local government.

This system of 'destroyed capitalism' was burdened by an extensive and increasingly inefficient *'socialist welfare state'* which included easily obtainable disability pensions, long maternity leave, relatively long holidays, heavily subsidized sanatoria, cheap holiday facilities for the employees of large state enterprises, etc.

The second typical feature was the *economic structure*, shaped by many years of forced industrialization under import substitution. The industry was 'overgrown' and the service sector underdeveloped. There was a heavy dependence on the Soviet market for exports in such sectors as machinery, textiles, electronics and pharmaceuticals, and for imports of oil and gas at below world market prices. Forty-four per cent of Polish exports in the last pre-reform year (1989) went to the CMEA compared with 45 per cent from Hungary, 51 per cent from Czechoslovakia, 63 per cent from Bulgaria, and 25 per cent from Romania (see Chapter 12). The inefficient economic system and socialist industrial structure left a legacy of serious environmental pollution, especially in regions with a high concentration of mining and heavy industry.

Like the other former socialist countries, Poland suffered from a profound shortage of specialists in marketing, finance, modern accounting and the professional civil service, i.e. in all the fields that are vital for a market economy to function properly. However, one of the few positive legacies of socialism was a fairly high level of *general education*, which allowed specific skills to be rapidly acquired.

Let us now turn to those aspects of the initial conditions in Poland

Table 16.1 *Poland's initial macroeconomic conditions in a comparative perspective**

	Poland	Czechoslovakia	Hungary	Bulgaria	Romania
(1) Broad money (end-year, %)					
1988	63.0	–	–	–	–
1989	526.50	3.5	13.8	10.6	5.3
1990	–	0.5	29.2	16.6	22.0
(2) CPI inflation (end-year, %)					
1988	73.9	–	–	–	–
1989	640.0	1.5	18.9	10.0	0.6
1990	–	18.4	33.4	72.5	37.7
(3) Fiscal balance (GDP %, last pre-reform year	−7.4	0.1	0.5	−12.7	1.2
(4) Repressed wage pressure 1987 until reform (%): change in deflated wage less change in deflated GDP	20.4	−9.1	0.6	20.3	21.6

Source: (1), (2), (3): *Transition Report* (1994), EBRD; (4): see Chapter 12, based on Bruno (1993), World Bank, national sources, and *Planecon*.

* The last pre-reform year for Poland is 1989 and for the other countries 1990.

which clearly departed from those typical for all socialist economies. The most important feature was the *dramatic state of the macroeconomy*. Table 16.1 shows that the macroeconomic imbalance in Poland during the last two pre-reform years was more serious than in Bulgaria and Romania, not to mention Hungary and Czechoslovakia. Poland was the only post-socialist economy (except for the former Yugoslavia) which started its economic transition from a position of near-hyperinflation and massive shortages. The latter are measured by the difference between the 1987-reform change in deflated wages and the same change in deflated GDP. On this measure, repressed inflation in Poland was far more dramatic than in Hungary and Czechoslovakia and similar to that in Bulgaria and Romania.

Another non-typical feature of Poland's initial situation was *the high level of foreign debt*, incurred mostly in the 1970s. Net foreign debt in the last pre-reform year stood at 44 per cent of GDP as compared to 16 per cent in Czechoslovakia, 61 per cent in Hungary, 63 per cent in Bulgaria and 2 per cent in Romania.

Poland's economic system contained fewer elements of the command mechanism and of input rationing than those of most other socialist economies, but it was less reformed than the Hungarian economy. However, the last pre-Solidarity government removed restrictions on the creation and development of private firms and considerably liberalized foreign trade.

Finally, there were two other features which were *strictly specific to Poland*. One of them was the *especially strong position of the workforce*, both within the socio-political system in general and within state enterprises in particular. This was caused by the peculiar nature of Poland's opposition, which originated in 1980 in the form of the trade union 'Solidarity'. After the 'Round Table' negotiations in the spring of 1989, 'Solidarity' was legalized, and it was strongly represented in Parliament. The agreement reached at the 'Round Table' included massive concessions to the more powerful groups of employees (for example, miners and railworkers) and an extreme form of wage indexation. All this had to be eliminated a couple of months later. The strong position of labour was likely to produce irresistible wage pressure and to reduce the scope for the central control of some important processes of change, such as privatization.

Another specific feature was the nominally *private ownership* of 78 per cent of arable land. However, the average size of the 2.7 million private farms was only 7.2 hectares and 30 per cent of farms had less than 2 hectares (their owners were usually farmer-workers). The farmers had functioned for many years in a non-market environment, characterized by a mixture of discrimination and state tutelage. In 1989 they received large *windfall gains*, thanks to large increases in the purchase prices of foodstuffs by the last Communist government. Also, hyperinflation in 1989 practically eliminated the real burden of taxation on farmers, which was low in any case.

Considering all the initial conditions in Poland, we notice that the nominally private agriculture may be regarded as on the positive side. However, given the extreme fragmentation of private agriculture, the windfall gains which had to be eliminated and the potential for numerous private farmers to be mobilized into conservative interest groups within the newly emerging democratic political system, even this feature appears to be a mixed blessing. The same may be said of the more decentralized nature of the Polish economic system. All the other non-typical characteristics of Poland's initial situation: the macroeconomic disaster, the especially strong position of labour and the large foreign debt, are clearly on the negative side. We may, therefore, conclude that the starting conditions in Poland were much more difficult than in Czechoslovakia (not to mention the Czech Republic), which had a much more favourable situation on all three counts. The conditions were also less favourable than in Hungary, which shared with Poland a large foreign debt burden, but had inherited a much better macroeconomic situation and much less labour militancy. The degree of the overall difficulties existing in Poland's initial economic conditions appears not to be lower than that of Romania, which had a much more rigid economic system but less dramatic (although serious) macroeconomic imbalance, was much less dependent on the Soviet market for exports and had no foreign debt. Only Bulgaria with its serious macroeconomic instability, large foreign debt, rigid economic system and especially high dependence on the Soviet market appears to have had more difficult initial conditions than Poland.

The Economic Strategy and the Conditions for Its Implementation

Economic strategy developed in three steps: (1) identifying the main problems arising from Poland's initial situation; (2) determining what kind of economy should be reached at the end of the transition process; (3) specifying the types of economic policy measures, their timing and the speed of their implementation.

Poland suffered from two main 'disorders': an extreme macroeconomic imbalance and a faulty economic system, which was responsible for a low and declining overall economic efficiency. There were two additional problems: the distorted economic structure and the huge foreign debt. They were, however, considered to be logically secondary to the macroeconomic and systemic 'disorders': one could not solve the structural and foreign debt problems without eliminating these deficiencies.

The vision of the target system played an important role in guiding the policy measures. They key assumption was that Poland had become free to choose, among other things, its economic order and that it should choose the system which would create the best chances for rapid, long-run economic development. Using this criterion it was easy to determine the main general features of the target economy: macroeconomically stable, competitive, capitalist, outward-looking, equipped with flexible labour markets, etc.

The third step consisted of linking the inherited problems to the perceived solutions. The macroeconomic imbalance called for macroeconomic stabilization (the *S* policy), i.e. reducing the budget deficit, controlling the money supply so as to move towards positive real interest rates. In addition, I believed that the institutional imbalance in wage-determination, due to the dominance of the public sector, required wage controls. The case for them was strengthened by the inherited wage–price spiral developed in 1988–89. Such controls were introduced within the comprehensive package of measures launched on 1 January 1990.

The fixed rate of exchange was another 'nominal' anchor. Specifying the level at which it had to be fixed constituted one of the most difficult decisions, preceded by a wide range of alternative proposals.[1]

Poland's macroeconomic imbalance was reflected not only in near-hyperinflation but also in *massive shortages* (repressed inflation). Shortages in Poland were due to both expansive macroeconomic policies and to the microeconomic distortions and rigidities of prices and supply. This was in contrast to Czechoslovakia, where, given conservative macroeconomic policies, shortages were mostly microeconomically induced. In the Polish case, the *S* policy was to take care of the open inflation and of the macroeconomic component of repressed inflation. The remaining microeconomic determinants of shortages called for microeconomic liberalization, or *L* policy; i.e. enlarging the scope of economic freedom by eliminating a massive and detailed state intervention so as to increase the flexibility of supply and prices.

The second main problem, the *faulty economic system*, required a *fundamental institutional transformation*. This policy, in turn, can be broken down into: (1) the already mentioned microeconomic liberalization and (2) fundamental institutional restructuring (I policy) which consists of transforming many organizations and whole institutional subsystems.

The *L* policy, therefore, constituted a common solution to both macroeconomic and the systemic problems. The programme of the *L* policy in Poland was very broad. It included the removal of the remaining restrictions on private activity, liquidation of the remnants of the central allocation of inputs, price liberalization, removal of the bulk of the quantitative restrictions on exports and imports, unification of the exchange rate and the introduction of the convertibility of the Polish zloty for current account operations.

The programme of *deep institutional restructuring* was also very

[1] The same was true of Czechoslovakia, where the setting of the rate of exchange at CSK 28 per US$ was preceeded by proposals ranging from CSK 16 to 35–40 per US$ (see Klacek & Hrncir, 1994).

pervasive due to the legacy of 'destroyed capitalism'. The most important steps were: privatization of the bulk of the state sector, breaking up domestic monopolies and introducing tough anti-monopoly legislation, strengthening the institutional independence of the central bank, reform of the financial sector, the reform of insurance, tax reform, the creation of genuine local government, and the establishment of a social safety net.

The *S*, *L* and *I* policies were assumed to be key elements of the solutions to two additional inherited problems: the distorted structure of the 'real' economy and the huge foreign debt. The economic structure is the product of past investment and production decisions, and these are strongly influenced by the systemic and macroeconomic framework. This is why a change in these two areas is crucial. But some parts of the industrial structure, where the need for quick downsizing was especially great and the informational requirements for the central decision-makers were relatively simple, called for and allowed a *strictly selective restructuring policy*. Such a policy, limited basically to mining, energy and metallurgy, was included in the overall economic programme. It had, however, nothing to do with the typical 'industrial policy' of picking winners or bailing out losers.

The future burden of the inherited foreign debt and the capacity to service it depended on Poland's development which in turn was strongly influenced by the policy of systemic transformation and that of macroeconomic stabilization. But given the huge size of the debt and the wretched state of the Polish economy, economic development would have been impossible without radical *debt reduction and restructuring*. The chances for obtaining such a reduction from the Western creditors, especially from the Western governments who owned two-thirds of the Polish debt, depended on Poland's adoption of a comprehensive and radical economic programme, which was in any case required on domestic grounds.

The economic strategy dealt not only with the type of measures to be taken, but also with their phasing and speed of implementation. Phasing determines how various measures are combined in time. For example, one could have delayed stabilization and price liberalization until enterprises were privatized. This was the essence of the 500 Days Plan in Russia proposed in 1990 but not implemented (Fisher 1994). This option was never seriously considered by the economic team in Poland, as it would have implied among other things tolerating inflation for a longer time, thus increasing the costs and difficulty of its eventual elimination. The alternative strategy of a largely simultaneous launching of *S*, *L* and *I* was thus selected.

Each policy measure has its maximum possible speed of implementation; it is much higher for *S* and *L* than for most of *I* policy. One can term 'radical' those policy options the speed of which is close to the maximum possible one. 'Gradualist' options by definition, clearly depart from this speed. Poland opted for radical stabilization. Trying to stop inflation slowly was perceived as a hopeless task. We also chose radical *L* and *I* policies to be launched together, and simultaneously with *S* policy. The case for such a strategy was based on the perceived failures of previous gradualist reforms and on the assumed existence of strong synergistic links between various policies. For example, radical price liberalization was required for a rapid improvement in relative prices without which, in turn, the autonomous decisions of enterprises could have socially undesirable consequences, and the bankruptcy mechanisms would have eliminated some efficient enterprises. Radical price liberalization was also needed for a rapid elimination of shortages, which was necessary both for consumers' welfare and for the more efficient operation of the enterprises. But such a liberalization had to be accompanied by swift elimination of quantitative and other restrictions in foreign trade in order to introduce competitive pressure on domestic enterprises, freed from the command mechanism; to increase the flexibility of supply which was along with price liberalization a precondition for eliminating shortages; and to link domestic prices to world market prices. All these links make for *indivisibility of liberalization*. Radical price liberalization and dismantling of the command mechanism (either in the form of traditional central planning or in the guise of 'government orders') were necessary for avoiding a situation whereby the controlled enterprises would lobby successfully for open or hidden subsidies, thus undermining required radical liberalization. Successful stabilization, therefore, required radical liberalization. Rapid price liberalization, however, had to be safeguarded by a tough *S* policy, if one were to avoid the initial price jump leading to sustained high inflation. Finally, it was assumed that privatization and other institutional reforms can bring full results only under increased macroeconomic stability, but also that some of these reforms (e.g. the tax reform) were needed to sustain and strengthen macroeconomic improvements. These were the mutual links between *L* and *I*.[2]

These economic considerations were sufficient for choosing a comprehensive and radical *S*, *L* and *I* programme. But there were also some important considerations regarding the political environment for

[2] These were some of the conclusions I reached in the 1980s in my work on comparative economic systems, on the inefficiency of the socialist economy and on its transformation (Balcerowicz 1989a and b).

the economic reform which strengthened the case for such a programme and for launching it quickly after the great political breakthrough that occurred in the middle of 1989. A gradual or delayed reform would mean wasting the political capital presented by public readiness to accept difficult radical economic steps. This sort of political capital is a typical benefit of any large-scale political breakthrough, but it quickly vanishes, giving way instead to 'normal' politics conducted by political parties, a game of special interests. Finally, social psychology tells us that people are more prone to adjust their attitudes to the surrounding environment when this environment has just undergone profound change than when it is going through gradual change.

This strategy was developed into a detailed programme in 1989 in cooperation with an IMF team and the assistance of a group of Polish and foreign advisers. A comprehensive and radical economic programme was launched early in January 1990. It focused on stabilization, liberalization, changes in the tax system and the social safety net. A comprehensive privatization law was accepted in February by the government and passed by parliament in July. Some other laws on the strengthening of the central bank and on institutional restructuring were passed in the first half of 1990, such as a law on insurance, an anti-monopoly law, a bankruptcy law, and a law disbanding the compulsory association of cooperatives.

The institutional reforms in 1991 included a new securities law and the establishment of a stock exchange, a new liberal foreign investment law, a law on a comprehensive income tax, and a new budgetary law. The growth of the private sector and the related privatization of state enterprises assets continued to be very rapid, but the privatization of larger state enterprises was rather slow, due mostly to political complications. On the macroeconomic front, in May 1991 the zloty was devalued and pegged to a basket of currencies instead of a previous peg to the US dollar. In October a crawling peg was introduced. Other changes included modification in the wage control mechanism, which was attacked by the trade unions but maintained.

The turn of 1991 and 1992 marked a visible political change. After the two reformist governments of Tadeusz Mazowiecki and Jan Krysztof Bielecki, the parliamentary elections in October 1991 gave rise to a coalition government of Jan Olszewski which started out claiming it would make a sharp break with the past. (The author ended his public service in December 1991.) But this government gradually toned down its revisionist declarations and, basically, continued a disciplined fiscal policy, constrained by a rather strict monetary policy of the largely independent central bank. However, privatization of larger state enterprises was practically brought to a halt. The Olszewski government collapsed in June 1992 and was replaced by the coalition government of Hanna Suchocka. It largely continued the economic strategy launched in 1990, although it made some concessions to various interest groups, especially farmers. This government was brought down by a non-confidence vote in parliament, which was then dissolved by the president; the elections in September 1993 gave rise to a coalition government of the two post-communist parties. It slowed down some institutional reforms, especially enlarging the competences of local government and banks' privatization. At least until 1994, it continued a disciplined fiscal policy.

As one can see, the Polish economic programme was implemented under complicated political conditions, especially after late 1990, and increasingly since the second half of 1991.[3] Frequent election campaigns gave occasions for displays of populism, which must have unfavourably affected the expectations and consequently the actions of economic agents; this resulted in renewed wage pressure and in the reduced inclination of state enterprises to take difficult restructuring decisions. With strong and rather aggressive trade unions, frequent elections and a fragmented party system, Poland had a much more difficult political environment for economic reform than Hungary or the Czech Republic.

Another group of conditions which could influence the economic transition were the external economic developments. In the case of Poland there was much difficulty, because of the collapse of Polish exports to the former Soviet Union and a sharp deterioration in terms of trade. The CMEA shock is estimated to have cost Poland between 3.5 and 5 per cent of its GDP in 1991. The relative shock was even larger for the smaller Central European economies; its impact on Hungary was put at 8 to 10 per cent, on Czechoslovakia at 6 to 9 per cent, on Romania at 10 per cent, and on Bulgaria at 16 to 21 per cent (Bruno 1993; Rodrik 1993; Rossati 1993).

Economic Outcomes

Before discussing economic outcomes it must be emphasized that the standard statistical data are bound to display a negative bias: on the one

[3] It is wrong to attribute these complications mainly to the radical nature of the economic programme (Balcerowicz 1993b). This is why political developments in Poland can be regarded as conditions which were largely independent from this programme but which influenced its outcomes.

hand, they are incapable of measuring the positive developments properly (for example, the rapid growth of the private sector on the elimination of shortages); on the other hand, they present as new social costs certain negative phenomena which were not shown before, because they used to exist in a disguised form (such as repressed inflation or hidden unemployment). The magnitude of this bias is likely to be especially pronounced in the case of radical economic programmes such as Poland's, as these reforms generate particularly rapid growth of positive processes which are underreported (like the growth of the private sector) and quickly turn the hidden costs into open ones, which are fully reported (see Chapter 12 for further details on this point).

In addition, in the Polish case complications related to hyperinflation before the reform had led the statistical office to serious mistakes; practically all of them have darkened the statistical picture of the subsequent transition.[4] Finally, some observers use the standard data in a way which does not make much economic sense and distorts the comparison of various post-socialist economies.[5]

Economic outcomes can be defined as changes in the magnitude of the four inherited problems: extreme macroeconomic instability, faulty economic system, distorted structure of the 'real economy' and the huge foreign debt.

MACROECONOMIC OUTCOMES[6]

The key macroeconomic outcome is the reduction of the magnitude of open and repressed inflation. The annualized consumer price index

[4] One example was to hugely overestimate the increase in stocks in 1990 which, *ceteris paribus*, led to an equal overestimation of the decline in consumption. For more on this and other mistakes see Bratkowski (1993), Rajewski (1993), and Berg (1993b)

[5] A popular fallacy consists in using 1989 as a base year for calculating subsequent declines in 'real' wages, which are regarded (explicitly or implicitly) as measures of changes in the standard of living. This procedure disregards the fact that in some countries (Poland in 1988–89, Russia in 1990–91) nominal wages by far outpaced prices in the pre-reform year, which inflated 'real' wages and contributed to their sharp decline during the reform. Needless to say, the rapid increases in 'real' wages resulted mainly in increased shortages (see Table 16.2). Such increases did not occur in Czechoslovakia or Hungary. Therefore, to take 1989 as a base year gives a false impression of declines in living standards. This mistake lies behind the claim that in 1990 'real' wages in Poland declined by 25 per cent as compared to, e.g. 4 per cent in Hungary in 1991. A more correct procedure is to take a pre-inflation year as base year, e.g. 1987. Relative to that base, deflated wages have declined by 9.4 per cent in Poland and by 10 per cent in Hungary (see Chapter 12).

[6] For the sake of brevity this section omits more detailed issues such as fluctuations in the budget deficit, the real rate of exchange or the stringency of the wage controls. These issues are discussed in Berg (1993a,b), Gomulka (1994); IMF (1994); Sachs (1993); and Wellisz *et al.* (1993).

during the last five months of 1989 stood at about 3,000 per cent (Herer and Sadowski, 1994). CPI inflation (end-year) in 1990 was 249 per cent, in 1991 60.4 per cent, in 1992 44.3 per cent and in 1993 37.6 per cent. While the level of inflation is clearly still too high, one should compare Poland's *disinflation* with those in high-inflation Latin American countries. In Chile and Mexico it took roughly seven years to reduce three-digit inflation to 15–20 per cent (Solimano, 1993). It should be stressed that disinflation in Poland happened while relative prices were radically altered and that this required huge rises in some key prices, especially those of energy.

Shortages and queues were quickly eradicated. Simultaneously, there was an improvement in the range and quality of goods. To begin with, this improvement was mainly due to imports, but in time it was increasingly due to the improved availability of domestic products.

Rapid disinflation and elimination of shortages resulted, as expected, from the combination of *S* and *L* policies. Radical stabilization took care of the demand component of both open and repressed inflation. The rate of growth of broad money declined from 515 per cent in 1989 to 166 per cent in 1990 and 58 per cent in 1992. The fixed rate of exchange until May 1991 and wage controls throughout 1990–93 helped to break inflationary inertia and inflationary expectations.[7] These *S* policies were necessary and sufficient to end hyperinflation. However, shortages are caused by price and supply rigidities, and – given these rigidities – magnified by expansionary monetary policy. Therefore in the Polish case the rapid elimination of shortages resulted both from radical macroeconomic stabilization and comprehensive microeconomic liberalization, i.e. price decontrol, removal of restrictions with respect to the private sector and foreign trade liberalization. These measures significantly increased the flexibility of supply and prices.

Table 16.2 shows that Poland achieved by far the most radical disinflation.[8] At the other extreme is Romania, where the inflation rate (end-year) was 7.5 times higher in 1993 than in 1990. Hungary achieved modest disinflation while the Czech Republic returned to its relatively low pre-reform level of inflation, followed by Slovakia. The most radical disinflation was accompanied in Poland with the lowest cumulative

[7] Pinto and van Wijnbergen (1994) have shown that wage controls in Poland played an important role in limiting wage increases.

[8] This is true even if we take the year 1992 for Poland to allow for the fact that the economic programme in Poland started a year earlier than elsewhere. The disinflation indicator is then still 0.07 (for end-year CPI).

Table 16.2 *Poland's macroeconomic developments in a comparative perspective, 1990–93*

	Poland		Czech Republic		Slovakia		Hungary		Bulgaria		Romania	
	End-year	Av.	End-year	Av.	End-year	Av.	End-year	Av.	End-year	Av.	End-year	Av.
(1) CPI inflation (%)												
1989	640.0	251.0	1.5	2.3	1.5	2.3	18.9	17.0	10.0	6.4	0.6	1.1
1990	249.0	585.6	18.4	10.8	18.4	10.8	33.4	28.9	72.5	23.9	37.6	5.1
1991	60.4	70.3	52.0	56.7	58.3	61.2	32.2	35.0	339.0	334.0	222.8	174.5
1992	44.3	43.0	12.7	11.1	9.2	10.1	21.6	23.0	79.0	82.0	199.2	10.9
1993	37.6	35.3	18.2	20.8	24.8	23.0	21.1	22.5	64.0‡	73.0	295.5	256.1
Disinflation†	0.06	0.14	1.0	2.0	1.3	2.1	0.64	0.74	0.9	3.0	7.5	50.0
(2) GDP (%)												
1990	−11.6		−1.2		−2.5		−3.3		−9.1		−8.2	
1991	−7.6		−14.2		−14.5		−11.9		−11.7		−13.7	
1992	1.5		−7.1		−7.0		−5.0		−7.7		−15.4	
1993	4.0		−0.5		−4.7		−2.0		−6.0		1.0	
Cumulative†	−13.8		−21.6		−26.1		−20.7		−30.4		−32.3	
(3) Consumption *%)												
1990	−11.7		2.4		–		−3.5		−0.6		9.0	
1991	3.3		−7.2		–		−5.3		−8.3		−11.6	
1992	5.0		−7.1§		–		−2.0		−7.7		−8.5	
1993	5.3‡		2.2		–		0–2		–		1.1	
Cumulative†	0.8		−8.8		−8.9		−8.7 to −10.4		–		−10.8	
(4) Fixed capital formation (%)												
1990	−10.6		6.5		5.2		−7.1		−18.5		−35.6	
1991	−4.5		−26.8		−28.1		−11.6		−19.9		−26.0	
1992	−2.8		3.8		1.0		−6.4		−1.5		−2.1	
1993	−1.0		−10.5		−21.0		0–5		−8.0		−0.8	
Cumulative†	−11.4		−28.6		−39.7		−19.2 to −23.0		−39.9		−53.2	

Source: CPI inflation: *The Transition Report* 1994; EBRD (forthcoming); other data: *Economic Survey of Europe in 1993–1994*.

Notes: * Measured by the ratio of 1993 inflation to the rate of inflation in the last pre-reform year (1989 for Poland, 1990 for other countries). † Calculated by linking the annual indices of GDP (with previous year = 100) from 1990 to 1993. ‡ Estimate, *Transition Report*, EBRD. § There are no official data for 1992; I have assumed a decline in consumption equal to that of GDP; i.e. 7.1 per cent. This assumption is on the optimistic side as, according to official data, gross fixed investment increased by 3.8 per cent.

declines in GDP, consumption and fixed capital formation.[9] The differences in the rates of this decline were a joint product of the differences in initial conditions, external conditions and economic policies. An extensive analysis is needed to assess the weights of these factors. We can only say here that the differences in the rates of decline in GDP cannot be fully explained by differences in the magnitude of the CMEA shock, suffered by the respective countries. Even after using the estimates above to eliminate the CMEA shock effects, notable differences remain in cumulative GDP decline: GDP in Poland is estimated to have declined by 8.8 to 10.3 per cent for non-CMEA reasons; the estimate for Hungary is 10.7 to 12.7 per cent, for the Czech Republic 12.6 is 15.6 per cent,[10] for Bulgaria 9.4 to 14.4 per cent[11] and for Romania 22 per cent. One should also remember that Hungary and the Czech Republic did not need to experience a contraction due to the macroeconomic stabilization shock, which was necessary in the Polish case because of its specific initial conditions. The other countries also suffered this stabilization shock to a lesser extent than Poland. Much remains, therefore, to be explained by the differences in economic policy. To my mind, one of the features which distinguished Poland's economic programme was radical and comprehensive liberalization (partly started as early as 1989), combined with a decisive increase in fiscal and monetary discipline. This combination of measures sharply reduced inflation and produced a very rapid growth of the private sector which was fuelled by the transfer of assets from the – financially constrained – SOEs. In time, increased autonomy, competition, hardened budget constraints and the anticipation of privatization induced a substantial number of state companies to adjust (Pinto *et al.*, 1993).

Among the other countries under comparison, Romania until late 1993 conducted an economic policy which was diametrically different from that pursued by Poland; it was a policy of stop-go gradualism in liberalization, and of maintaining a soft budget constraint with respect to the SOEs (see Chapter 12). It should not, therefore, be surprising that compared to Poland, Romania achieved the worst results both with

[9] This conclusion remains true if, for the sake of complete comparability, we take for Poland the period 1990–92, and for other countries 1991–93.

[10] The decline in the Czech GDP corrected for the estimated reduction in GDP due to the CMEA-shock is even larger because this estimate of 6–9 per cent referred to the former Czechoslovakia, and the Czech Republic was less affected than Slovakia.

[11] The relatively low figures may to some extent be due to the fact that in 1992 Bulgaria reduced the official estimate of the decline in real value added between 1989 and 1991 by about 12 percentage points (see Bartholdy, 1994).

regard to inflation and to GDP. Romania's initial economic conditions do not appear to be more complicated than Poland's. Romania's performance suggests, therefore, what would have happened to the Polish economy during 1990–93, had Poland rejected a comprehensive and radical economic programme and opted instead for a much 'softer' approach.

The above remarks on Poland's disinflation-GDP performance *relative* to other post-socialist economies were based on official statistics – not only out of necessity but also on the assumption that the 'negative bias' in these statistics is not *less pronounced* for Poland than for other countries (see previous section). This assumption is not justified, however, if one wants to compare with Polish economic performance (or that of other post-socialist economies) with the performance of non-postsocialist countries; in the latter the transition-specific statistical biases are not present. For such comparisons one should use, for Eastern European economies, data which are freed from such distortions. This is especially necessary with respect to the GDP declines, which conventional wisdom holds to be 'unprecedented', and comparable only with the contraction experienced by the Western countries during the Great Depression. This view, however, does not hold water, at least in the case of Poland. An investigation conducted by the Research Centre of the Polish Statistical Office ('Rachunki narodowe . . .', 1993) puts the corrected cumulative decline in Poland's GDP at about 14 per cent for 1990–91, at 12 per cent for 1990–92 and at 8 per cent for 1990–93. These corrections did not include the effects of the unrecorded growth of the private sector. Another investigation estimated the impact of this factor but disregarded other biases and ended with an estimate of a 5–10 per cent decline in Poland's GNP in 1990–91 (Rajewski 1993). These estimates, for a country which started its radical economic transition under hyperinflation and experienced powerful shocks, should be compared with the contradictions suffered by some non-postsocialist economies. During the Great Depression GDP declined in the USA by 30 per cent, in Germany by 23.5 per cent, and in France by 16.7 per cent. In Great Britain, during the transition from a war to a peace economy after 1945, aggregate output declined by more than 10 per cent below the peak of the 'war economy'. And 'out of 129 countries for which data are available over the approximate period 1960–89/90, more than half have experienced at least one period of cumulative losses . . . of 10 per cent or more.' Among them was Chile with a contraction of 18 per cent, Argentina with 12 per cent, Peru with 18 per cent and Uruguay with 16 per cent (Fozouni *et al.*, 1992).

SYSTEMIC OUTCOMES

Systemic outcomes are changes in the relative prices and in the institutional framework of the economy. The main changes are outlined in this section.

On account of the radical liberalization carried out in early 1990 and supplemented by the decontrol of the price of coal in 1991, about 90 per cent of the total volume of transactions was conducted at *free prices*. Price liberalization and radical increases in the controlled prices of energy produced a *much improved structure of relative prices*. A synthetic measure of this improvement is that the ratio of the official rate of exchange to the purchasing power parity rate fell from almost 5 in late 1989 to 1.9 at the end 1993, compared with 3 to 2.5 for the Czech Republic; and to 2.4 to 1.7 for Hungary (*Polish Economic Monitor*, 1994).

The role of money as a medium of exchange increased significantly, as the Polish zloty became freely convertible into goods (thanks to the elimination of shortages). The unification of the exchange rate made a huge contribution to the improvement in relative prices and led to the convertibility of the Polish zloty for current account transactions. The Polish zloty, therefore, became convertible not only into goods but also into other currencies. The reduction in inflation and a sharp rise in real interest rates also greatly enhanced the role of the Polish zloty as a medium for savings.

The liberalization of the general regime of property rights and foreign trade liberalization, carried out in 1988–89, allowed *free entry* into the Polish economy. As a result, in 1990–93 more than one million new private firms were created (Gomulka & Jasinski 1994).

The *exit mechanisms* have been strengthened at a much slower pace. They hardly existed at the start of the reforms, and it takes much longer to develop them (for example, to train bankers, bankruptcy judges and liquidators), than to remove the restrictions which block free entry. Also, economically justified exit requires proper relative prices, and these take some time to appear. But the delay of exit processes was longer than planned, because the state enterprises had more reserves (stocks of raw materials bought at the low prices, foreign currency deposits, real assets to be sold or leased, etc.) than had been expected. As a result, outright liquidations and bankruptcies in 1990–91 were fewer than expected, but many large enterprises underwent a radical down-sizing by selling or leasing assets to the private sector, which contributed to the development of that private sector. This *gradual form of exit* turned out to be the dominant one. It was brought about by a visible hardening of the enterprises' budget constraints: the correlation between profits across enterprises before and after taxes and subsidies increased for a sample of 1,899 large industrial enterprises from 0.38 in 1989 to 0.71 in 1991 (Berg 1993b).

Poland's economy has been becoming increasingly more private. The share of the private sector, excluding agriculture and cooperatives, grew from 13.2 per cent of the total workforce in 1989 to 34.4 per cent in 1992. If we include agriculture and cooperatives, the share of employment in the private sector jumps to about 60 per cent of employment at the end of 1992 and to about 50 per cent of the GDP. The share of output produced by the private sector in manufacturing increased from 7.4 per cent in 1989 to 36.6 in 1993, the corresponding figures for construction output are 33.4 and 85 per cent.

The rapid privatization of the Polish economy was mainly due to the fast development in the private sector, which was supported, as noted, by the transfer of assets from the state enterprises through leasing or sales (Berg 1993b; Rostowski 1993; Gomulka & Jasiński 1994). The privatization of small and medium state-owned enterprises has been rapid, but privatization of large enterprises was rather slow, because of political factors such as frequent changes of governments and privatization ministers. Proposals to accelerate privatization began to become the subject of political struggles in the second half of 1991.

The rapid growth of a number of mostly small private firms, the spontaneous down-sizing of the larger state firms and the de-monopolization of a number of industries imposed by the government in 1990–91 (for example, in the meat industry, the sugar industry and bus transport) produced a rapid *organizational deconcentration* of the Polish economy. Employment in industrial firms with 51–100 employees increased in 1989 to 1991, by 202 per cent, while that in firms employing over 5,000 workers declined by 35.6 per cent (Góra 1992). There was a surge in employment in small firms (those with up to 50 employees). This is, however, not captured by Polish official statistics.

The organizational deconcentration, combined with the liberalization of foreign trade and a liberal regime of property rights has increased the flexibility of supply and the competitive pressure upon the suppliers.

In the first half of the 1989 Poland's banking sector started to depart from the typical socialist *banking sector*, characterized by a monobank structure with its non-commercial criteria for the allocation of credits, total quantitative controls of the volume of credit, no clear separation between the banking system and the state budget, a ban on trade credit, etc. (Balcerowicz 1993a). There has been an accelerated change and much 'learning by doing' in the banking sector since early 1990. The central bank has been made more independent of the government and Parliament and its policy towards the commercial banks has become increasingly market-based and indirect (Kostrzewa 1994).

The number of commercial banks increased from seven to more than eighty (disregarding the cooperatives), and they have undergone a thorough technical modernization process and transition to commercially-based lending practices under growing competition. However, the lack of experience and the unusual level of uncertainty in the economy due to the very process of its transformation under powerful external shocks, have led to the accumulation of bad debts. They were *estimated to be at the level of 20 to 30 per cent* of the banks' total portfolios by the end of 1992 (*The Banking System in Poland* 1993) and at 5.2 per cent of Poland's GDP. In early 1993 an innovative law on the financial restructuring of banks and enterprises was adopted to deal with the issue.

In May 1991 nine large commercial banks were turned into joint-stock companies and staffed with independent supervisory boards in order to shield the banks' management from political interference. Three banks had been privatized by March 1994.

Another segment of the financial sector, *the non-banking financial institutions* and the stock exchange, had to be built totally from scratch. A technologically modern stock exchange was opened in July 1991. There is a small but growing number of non-banking financial institutions, providing equity capital. They should play an increasingly important role as they are on average better suited than the banks to finance projects with high levels of risk, of the kind that is inherently linked to economic transition.

During 1990–93 Poland made the transition from the complicated and fragmented *tax system* typical of a socialist economy to a modern Western-type system. The corporation tax was stripped of its previous numerous exemptions. A modern personal income tax was introduced early in 1992, and a value added tax in July 1993. The tax offices were increasingly computerized and a fiscal police department was introduced in 1992. Despite all these developments, tax evasion has undoubtedly grown. This is largely an unavoidable consequence of successful liberalization, which has resulted in the rapidly growing number of mostly small and private firms and the inevitably slower pace at which the tax administration has been strengthened (see also Chapter 13).

On the *expenditure side of the fiscal system*, many extra-budgetary funds were eliminated in 1990 making Poland's public finances much more integrated and transparent. Budgetary procedures were clarified and streamlined thanks to a new budgetary law enacted in 1991. There were some changes in the financial framework of the health service. But a fundamental reform is still under discussion.

Along with the introduction of a radical reform programme in early 1990 and the related elimination or drastic reduction of price subsidies and the reduction of the role of state enterprises as centres of welfare services, a targeted system of *unemployment and social assistance* has been developed. However, it still leaves much to be desired.

The pension and invalidity system turned out to be a special problem in Poland's transition to a market economy. Because of demographic trends, the overgenerous indexation of pensions introduced in 1990, and the regulations which allowed employees to obtain a pension while continuing to work, the share of social security subsidies in total budgetary expenditure increased from 13 per cent in 1989 to about 28 per cent in 1993 and pension expenditure jumped from 7 per cent of GDP in 1988 to 15 per cent in 1993 ('Emerytury i renty . . .' 1993). The number of pensioners in Poland increased by 4.1 per cent in 1990 and by 11.8 per cent in 1991, compared with 1.1 and 2.1 per cent in Czechoslovakia. This difference explains much of the difference in the fiscal developments in 1991–92 between the two countries (Barbone & Marchetti 1993). The future of the pension system became a political issue in 1990, so only a partial correction to the regulations has been possible, and this problem has contributed to a fiscal crisis.

Conclusions: *on the systemic outcomes* Poland has made large strides towards a competitive, private-enterprise market economy. There has been a huge improvement in the structure of relative prices and in incentives for exports, input saving and quality-enhancing innovations. The ownership structure has been changing rapidly, mainly due to the radical *S–L* programme and less so to the privatization of the state-owned enterprises. Due to the unavoidably slower pace of thorough institutional restructuring, product markets have been improving much faster than the labour and capital markets. The developments in the pension system have probably been the weakest part in Poland's economic transition. Another weak spot has been the slow pace of privatization of the larger state-owned enterprises, due to political complications. The remaining agenda includes privatization of most of the remaining state-owned enterprises and of the banks, the development of the financial sector, carrying out major reforms in the health service, education and the social security system. These reforms are necessary to increase efficiency and the macroeconomic stability of the Polish economy and thus to sustain rapid economic development.

CHANGES IN THE 'REAL' ECONOMY

The macroeconomic stabilization and the market-oriented reform produced many important changes in the real economy.

Output restructuring at an aggregate level is reflected in the declining share of industry (including construction) from 52.3 per cent of the GDP in 1989 to 46.6 per cent in 1991. In contrast, the share of the service sector has increased from 34.8 to 46 per cent (*Rocznik Statystyczny* 1993).

Telecommunications have been growing rapidly: the number of telephones installed between 1985 and 1989 increased by 38,000 and between 1989 and 1993 by 310,000 (*Biuletyn Statystyczny* 1994). Thus the fastest growing sectors have been the ones which were the most neglected under socialism. But the most important changes in the composition of output have been reflected in the introduction of many new or improved products in practically every industry. This is largely due to the adaptation and imitation of goods from the more advanced countries – a rational procedure for a latecomer.[12]

Output restructuring is part of a broader process of *technical change and improved efficiency*. There are so far no studies which would show the changes in total factor productivity, country-wide or with respect to the large sectors,[13] but all the available partial information indicates that the typical symptoms of socialist inefficiency are rapidly disappearing:

- The tonnage of goods transported has declined by 43 per cent between 1989 and 1992 (*Biuletyn Statystyczny* 1994), much more than the decline in GDP. This reflects both the reduction in the relative importance of mining and heavy industry and the rationalization of the network of supplier–buyer relationships.
- The value-added produced in private agriculture increased by 4.8 per cent in 1990 and by a further 24.7 per cent in 1991 as a result of economizing on the use of inputs of chemical fertilizers and pesticides in response to their sharply increased prices.

[12] Polish hardware and software computer firms numbered 800 in late 1993, with total sales of about 1 billion US dollars. Warsaw Computer Expo fairs are the largest and most prestigious event of this kind in Central and Eastern Europe (*Gazeta Bankowa*, Komputer Expo 1994). Another indicator is the surge in the number of new product types exported to Germany: 3,500 in 1993 against 1,500 in 1992, consisting mostly of high quality products (Mylonas, 1994)

[13] Such studies should operate with measures of aggregate output, corrected for improvements in the quality and availability of goods, which are not captured by the conventional statistics.

- The traditionally low share of expenditure on machines and equipment has been rising; it was higher in 1993 than in 1989. In contrast, expenditure on construction has been declining. This is mainly due to the shift from the large state-financed investment projects to numerous small and increasingly privately financed projects, with the focus on renovation and modernization.
- Investment in machinery and equipment has been growing rapidly. Especially rapid growth occurred in imports of investment goods from the OECD countries, which in 1990–92 rose by over 150 per cent (Bratkowski 1993). This may be interpreted as an indicator of the growth of the technical quality of the installed machines and equipment.

Since 1990 there has been a *rapid decline in the volume of all types of pollutants*. The amount of waste water fed into rivers in 1992 was 40 per cent lower than in 1989; that of liquid pollutants declined by 50 per cent, and the emission of gaseous pollutants decreased by 40 per cent. This decline in the production of environmental 'bads' has been achieved by the aforementioned changes in the structure and efficiency of production. At the same time outlays for environmental conservation and to save water increased from 3.7 per cent of total national investment in 1990 to 6.5 per cent in 1992 (*Rocznik Statystyczny*, 1993).

Profound changes occurred in the role of *foreign trade*. Exports to the West increased by 60.8 per cent in 1990–91 and by 13 per cent in 1992–93; imports by 53 and 40 per cent.[14] This appears to represent trade expansion and not just the effect of the reorientation of exports from East to West (Mylonas 1994). Poland became a much more open economy, much more strongly linked to the advanced economies of the OECD countries, especially Western Europe. The annual inflow of *foreign direct investment* increased from about US$ 60 million in 1989 and US$ 105 million in 1990 to over US$ 1.5 billion in 1993 (Kubielas, 1994).

Radical changes in relative prices and the removal of shortages brought about rapidly increased *purchases of consumer durables* which became relatively cheaper and much more available on the market. As a result there has been a fast rise in the share of households possessing them – see Table 16.3. Interestingly enough, this jump in the possession of consumer durables was not accompanied by a decrease in the average consumption of meat or fruit. At the same time the share of total

[14] In 1992 to 1993 there has been a large increase in Polish–German cross-border trade, consisting mostly of Polish exports which were not recorded in the official trade statistics.

Table 16.3 *Percentage of various kinds of households possessing particular consumer durables (end of year)*

	Employee households (%)		Farm households (%)		Pensioner households (%)	
	1989	1992	1989	1992	1989	1992
Radio (stereo)	22.6	40.8	6.0	14.8	5.4	13.4
Colour TV	50.7	91.4	19.8	48.9	21.0	52.7
Video player	4.7	53.4	0.9	15.5	0.7	13.5
Tape recorder (stereo)	24.3	49.8	8.0	24.6	4.3	13.4
Automatic washing machine	59.1	69.7	23.2	28.5	27.3	39.5
Freezer	20.3	30.3	33.7	56.6	9.1	16.3
Car	30.7	41.4	30.4	41.7	9.2	15.0

Source: GUS (Main Statistical Office).

expenditure going on energy increased sharply, due to a radical increase in energy prices from an extremely low level in 1989.

The last Polish change to be discussed refers to the labour market. The radical economic programme in Poland brought about a decline in official employment and a sharp increase in recorded unemployment.[15] From 1990 to 1992 total employment in Poland declined by 10.4 per cent, as compared to 8.8 per cent in the Czech Republic, 13.5 per cent in Slovakia, 12.1 per cent in Hungary, 28.7 per cent in Bulgaria and 4.5 per cent in Romania.[16] Official unemployment at the end of 1992 stood in Poland at 13.6 per cent, in the Czech Republic at 2.6 per cent, in Slovakia at 14.4 per cent, in Hungary at 12.9 per cent, in Bulgaria at 16.4 per cent and in Romania at 10.1 per cent. Thus, the decline in employment in Poland was (disregarding Romania) the lowest after the Czech one. The

[15] The reader must be warned that the official concepts of employment and unemployment, borrowed from the market economies, are highly misleading in transition economies. Formal employment includes hidden unemployment, which varies widely across the latter economies, depending on their economic programme. This, of course, bears directly on the level of official unemployment. For example, on the formal definitions, there was full employment in Ukraine in 1993 and unemployment of 15.7 per cent in Poland, while the decline in Ukrainian GDP from 1990 to 1993 was 39.3 per cent, while in Poland GDP declined by 13.8 per cent. Also, official unemployment includes an increase in the number of people employed in the second economy, and that number also varies across transition economies. It was estimated that in the region of Łódź, in Poland, one with an especially high rate of unemployment, the number of people employed in the second economy equalled that of recorded unemployment persons (Iwaszkiewicz & Zarychta 1994).

[16] Data drawn from *Economic Report* (1994) except for Poland, for which official Polish data are used (IMF 1994).

relatively high unemployment rate in Poland, especially as compared to that in the Czech Republic, cannot be attributed, therefore, to particularly unfavourable developments on the employment side, but to other factors. These include differences in the eligibility rules for unemployment; tougher rules in the Czech Republic must have led more workers to be non-participants rather than unemployed. If similar rules were applied, the excessive difference between the unemployment rates in Poland and the Czech Republic would have been much smaller (Blanchard *et al.*, 1993).[17]

The difference between the rate of decline in GDP and in that of employment may be used as a rough indicator of the change in hidden unemployment or excess employment (cf. *Economic Report* 1994). For 1990 to 1992 this indicator was: Poland 6.7 per cent, the Czech Republic 10.8 per cent, Slovakia 9.9 per cent, Hungary 7.0 per cent, and Romania 28.5 per cent. (Only Bulgaria with its extremely deep decline of employment recorded a reduction (of 2.8 per cent) but see fn. 11.) In 1993 a strong growth of GDP accompanied by a decline in employment reduced the discussed measure in Poland to 0.9 per cent; lack of growth in other countries must have meant that if there was a reduction, then it was only through a decline in employment.

As one can see, Poland has been undergoing not a traditional recession but profound institutional, economic and technical restructuring (cf. Berg 1993a) of the supply side. These supply-side transformations combined with macroeconomic stabilization have enabled Poland to achieve economic growth in the third year after launching its radical economic programme, despite powerful external shocks and rather unfavourable domestic political conditions.

FOREIGN DEBT

After tough negotiations Poland concluded in April 1991 an unprecedented agreement with the Paris Club which owned about two thirds of Polish debt. Thanks to this agreement the net present value of the debt was reduced by about 50 per cent in two tranches. Negotiations with the London Club were delayed by the change of government in Poland in 1992–93, and agreement for a similar degree of debt reduction was finally concluded with them in March 1993.

[17] For more on the reasons for the exceptionally low level of official unemployment in the Czech Republic see BIS (1994).

The Lessons Learned

Polish economic reform points out to a number of specific lessons:

- Traditional tools of macroeconomic stabilization (reducing the budget deficit, controlling the money supply and providing some nominal anchors, such as a stabilized rate of exchange) work in a largely socialist economy. But they probably have to be supplemented by an additional instrument – strong wage controls – which takes care of an important characteristic of a socialist economy: the influence of the wage-earners in the wage-setting process due to the inherited dominance of the public sector. The case for such controls is further strengthened if, as in Poland in 1988–89, the country has developed a wage–price spiral.
- A radical stabilization–liberalization programme is capable of abolishing massive shortages in a couple of weeks and of increasing substantially the range of goods available to buyers in the course of one or two years. This has shown, as expected, that shortages were caused by widespread price and supply rigidities, and – given these rigidities – were magnified by an expansionary monetary policy. This experience casts doubt on the alternative view, made popular by Janós Kornai, that relates shortages principally to the soft budget constraints of enterprises.
- The Polish example shows that it is possible to introduce internal currency convertibility in one move instead of doing it gradually over a couple of years, as was the case in Western Europe in the 1950s.
- Radical stabilization and liberalization forces many state enterprises to sell or lease part of their assets to private firms. In this way, radical stabilization and liberalization contributes to the rapid growth of the private sector and thus to the privatization of the entire economy.
- Radical stabilization and liberalization induced many state enterprises to adjust to the more demanding, but also potentially more rewarding, conditions of the market economy (Pinto *et al.* 1993). However, an even larger increase in their overall economic performance could have been achieved, on average, if they had been privatized. For this performance is determined both by the environment of enterprises, shaped mainly by S-L policies, and by their structure. These two factors are in an additive relationship. Changing both can result, therefore, in larger improvement in enterprise performance than changing just one. In addition, a large

state sector is likely to be increasingly politicized, and will tend, therefore, to undermine the initial gains in the efficiency of SOEs.

- The radical economic programme induced widespread restructuring of output and rapid reductions in the typical inefficiencies which prevailed under the socialist economic system. Output restructuring and increased efficiency have, in turn, brought about a rapid decline in the emissions of environmental pollutants.
- Poland achieved a better disinflation-GDP performance in 1990–93 than other countries of the region. The reasons for that require further examination. We can point out here, that the lesser magnitude of external shocks (however significant) and initial conditions are not sufficient to explain these differences. One must look, therefore, to features of the economic policy.

This brings us to a *general lesson*: the strategy described above has proved right in the sense that different strategies, given Poland's initial and external conditions, would have brought about much worse results. In this sense the Polish economic programme has been a success.[18]

I can see three main reasons for this. First, being radical and comprehensive, the programme was able to break down the inertia and structures of the inherited economic system, respected the links and synergies between the various processes of economic reform and could benefit from the political capital that emerged in the wake of the great political breakthrough of 1989. Second, the programme was, on the whole, implemented consistently in spite of growing criticism and pressure, especially in 1991. Third, one of the basic rules in devising and implementing the programme in 1990–91 was to avoid differentiating between sectors or – even worse – between enterprises. Introducing the new general rules was considered absolutely essential to create a transparent legal framework, to improve efficiency and to avoid pervasive rent-seeking by various interest groups. It is in these last two features in particular that the Polish economic reform of 1990–91 strongly differs, in my opinion, from that in Russia and most other post-Soviet countries. Another important difference is that in Poland the decisive stabilization effort came at the very beginning of the economic transformation process, while in Russia it came later, to be interrupted

[18] Some critics use a yardstick for judging this programme its original targets, and then point to deviations from these targets to condemn the programme as a failure. This approach ignores the role of uncertainty, which must be especially pronounced in a transition economy experiencing powerful shocks, and confuses forecasting errors with policy mistakes. Besides, the revised data, especially with respect to GDP, substantially reduces the gap between the original targets and the results achieved.

after only a couple of months in the middle of 1992; in Ukraine it has been delayed for longer.

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Conclusion: Personal Reflections on Poland

I would like to end this book with some personal recollections of my experience of having extraordinary responsibilities during extraordinary times. I hope that these remarks will both provide readers with an understanding of the Polish transition, and some broader insights as well.

How I Became a Reformer

I was helped in this respect by my education and, later, my research. I graduated in 1970 from the Faculty of Foreign Trade of the Warsaw School of Planning and Statistics (now the Warsaw School of Economics), which was probably the most Western-oriented faculty of economics in the Comecon countries in the late 1960s.

Between September 1972 and January 1974, I studied business administration, specializing in economics, at St John's University in New York, which gave me an opportunity to get better acquainted with Western macro- and microeconomics. While working on my doctoral dissertation, I read widely on the economics of technological change .

In 1974, I returned to the Central School of Planning and Statistics

I am drawing on selected fragments of my book *800 dni. Szok Kontrolowany*, Warsaw, 1992. I am grateful to Amanda Klekowski and Marek Michalski for translating them into English. I have also used some parts of my contributions to the book edited by Mario Blejer and Sylvio Corricelli, *The Making of Economic Reform in Eastern Europe: Conversation with Leading Reformers in Poland, Hungary and the Czech Republic*, Studies of Communism in Transition (Edward Elgar, 1995).

in Warsaw, where I taught international economics while working on my doctorate, which dealt with the social costs of speeding up product innovations. I defended it in 1975.

Since the early days of my academic career, I've had a feeling that 'institutions matter', that is, that behind differences in economic performance there are differences in institutional arrangements or, in other words, in economic systems. This led to my interest in the economic reform of the socialist system.

In 1978 I formed and directed an informal group of young economists working on a project for economic reform in Poland. This group became widely known as 'the Balcerowicz group'. The result of our intensive work (we met almost every week for more than two years) was a thorough discussion of many important issues, including how to prevent workers in cooperative enterprises from consuming profits, what instruments of indirect control the state should have in the economy, how to build a two-tier banking system and what powers a local government body should have.

When in August 1980 Solidarity came into being, there was a great demand for 'social' – that is, unofficial – proposals for economic reform, and 'the Balcerowicz group' project was recognized by many as the most radical and complete. It generated wide interest among members of Solidarity, which for myself, as for many other Poles, was important as a broad-based movement for reform rather than as a trade union. In March 1981 I was elected vice-chairman of the Polish Economic Association with responsibility for economic reform (from which I resigned in December 1982 because I believed that, in the situation created by martial law, radical economic reform had little chance of being pursued). From 1982 onwards, the task force on economic reform became something of a seminar on the basic problems of economic systems (that is, property rights, the proper role of the state in the economy, shortages and inflation) and continued at a lesser pace until democratization in 1989.

I entered the government in September 1989 with some members of the original group and others who had joined it later. There was no doubt among the members of the economic team that a radical economic change was imperative. The views about the general directions of the reform were shared partly because they had been discussed beforehand, during the seminars in my institute.

One of the basic questions I was interested in as a student of economic reforms was, first, why the economic reforms in the socialist countries had been partially or wholly reversed, and secondly, why they had failed to bring about any significant increase in overall efficiency.

My general response to these questions was that the economic reforms failed because they were not radical enough, that is, they did not reach a certain threshold of necessary changes rapidly; in other words, a 'critical mass' of such changes was not achieved. So I entered the government with a strong 'anti-gradualist' attitude towards economic reform. This belief was based not only on the experience of the previous reforms, but also on the conclusions I drew from social psychology, especially from Leon Festinger's theory of cognitive dissonance. One of the findings of this theory is that people are more likely to change their attitudes and their behaviour if they are faced with radical changes in their environment, which they consider irreversible, than if those changes are only gradual.

With respect to the content of the 'critical mass', my view was that a centrally managed economy had a certain 'constructional logic': being a non-market economy it relied on targets, rationing and administrative prices, which in turn require monopolistic and heavily concentrated organizational structures. Such structures could be maintained only if organizational rights, that is rights to set up, reorganize and liquidate enterprises, were largely in state hands. According to this view, the critical mass should break up the 'constructional logic' of the system by liberalizing prices and foreign trade, removing all the remnants of central allocation of goods and services, breaking up the domestic monopolies and decentralizing the organizational rights – in other words by introducing the freedom of entrepreneurship (liberal rights).

I was also familiar with the main examples of reforms in the non-socialist countries. Indeed, one of my main interests in the 1980s concerned economic transformations that brought about unexpectedly good results. I spent five months in 1985 as a visiting fellow at the Institute of Development Studies at the University of Sussex in England, investigating the South Korean case, and to some extent the Taiwanese economy. In the autumn of 1988 I spent three months in Marburg in West Germany studying the effects of Ludwig Erhard's reforms in 1948. I was also interested in the stabilization programmes in Latin America.

With respect to stabilization, I knew that, irrespective of the institutional differences, a radical approach was needed to put the brakes on the momentum of hyperinflation. The institutional differences had, I felt, two consequences. First, given the asymmetry of the labour market, because of the absence of private owners in what was still a socialist economy, there was a need for extraordinarily tough wage controls to rein in the tendency towards runaway inflation. Second, because the tough programme of stabilization had to be introduced into a basically non-private economy, its supply response was more uncertain and could be even worse than that seen in Latin American economies. But the alternative strategies had, I believed, much less chance of success.

With respect to the elimination of shortages, I believed the problem was price controls and the rigidity of supply, and not the 'soft budget constraint' of enterprises. The latter, in my opinion, was one of the main factors responsible for their low efficiency, as it implied the absence of competition.

Another important lesson was that the absence of competition, import substitution and the heavy regulation of the economy are sufficient to cause low efficiency and widespread rent-seeking; formally, private property cannot remedy this situation. These were the negative conclusions I drew from the experiences of many Latin American countries and India, and from the economic literature, especially from the writings of Bella Balassa and Anne Krueger.

In the spring of 1989 I wrote a paper on the conclusions to be drawn from the experience of various economies, and from economic theory, regarding the changes desirable in the Polish economy. I had no idea that a few months later I would be in charge of the Polish economic stabilization and transformation. But the conclusions were rather similar to the main points of the economic programme adopted in the autumn of 1989: rapid liberalization of prices, tough macroeconomic policy, convertibility of the Polish zloty, the liberalization of the foreign trade regime, the fastest possible privatization, and so on.

The Diagnosis and the Therapy

When I entered into government in September 1989, I perceived that the key objective was to put the Polish economy on the path towards efficiency and to improve the average standard of living. To do so required dealing with the macroeconomic disaster and solving the structural problem of low and declining efficiency. I had a clear perception from the very beginning that because of the inherited hyperinflation, we had to choose between an almost hopeless strategy and a risky strategy. There was no option without risk. An almost hopeless strategy would have consisted in neglecting the stabilization part of the programme, and in focusing instead on the transformation part.

It was my view that the strategy of tolerating hyperinflation would make stabilization more and more difficult with the passage of time, and the related chaos of hyperinflation would make rapid transformation, including privatization, scarcely possible. So this strategy, 'privatization first, stabilization later', would probably have resulted in neither privatization nor stabilization.

It was thus reasonable to choose a strategy that was merely risky but not hopeless: that of starting stabilization and transformation at about the same time. Stabilization measures and the liberalization part of the programme of transformation could be implemented more rapidly than privatization and other drastic institutional reforms. The radical strategy consisted, therefore, in the rapid introduction of a linked stabilization and liberalization package while at the same time undertaking more time-consuming institutional reform. This implied, given the differences in the possible speed, that radical stabilization and liberalization had to be introduced in the economy before it was fundamentally transformed. The risk in this strategy was that the supply response of such an economy was weaker and could be more uncertain than in a free-market economy. But I always compared these risks with those of delaying stabilization or liberalization (or implementing them gradually). It was obvious to me that the latter strategies are almost hopeless.

I perceived some uncertainty about the possibility of implementing and sustaining the chosen strategy. But my task on accepting appointments as both deputy prime minister and minister of finance was to push through the radical strategy, as the positions did not in themselves hold much attraction for me. So my attitude was that if it turned out to be impossible, I would resign, and I certainly would have done so. The worst possible scenario for me was to preside over an economic programme that was politically acceptable but failed, because it was not sufficiently radical and consistent.

What I had in mind as a warning was the fate of Raul Alfonsin in Argentina who started a radical stabilization programme as a very popular politician and who lost both the popularity and the stabilization. This is why I tended to prefer those policy options which were associated with the higher risk of being rejected by society but which, if implemented, promised to bring better economic results than those that were socially less risky but economically also less promising.

There were some specific concerns about the working of the respective mechanisms. Perhaps the single most important source of perceived uncertainty was the convertibility of the Polish zloty, which we decided to introduce at a low level of foreign exchange reserves. This is why it was so important to obtain the US$1 billion for the stabilization fund.

Practically all the important economic variables were subject to great uncertainty. For example, there were conflicting hypotheses about how fast the initial large price increases would spread across the economy; in other words what the inflation path would look like. I did not know how long we would be able to keep the exchange at its initial level. We were uncertain when and on what scale the bankruptcies of enterprises would occur. In fact, they started later and on a smaller scale than we had expected. We forecast a moderate growth of exports in 1990. In fact, they exploded, growing by 43 per cent.

However, I was reasonably certain about the general directions of change, that is, the general relationships between the policy measures and the changes in the economic variables, the time lags between the two, and the magnitude of the reaction. Therefore, I was sure that the stabilization and liberalization package, if maintained, would stop hyperinflation and eliminate shortages. I was also sure that sooner or later, privatization of the economy, competition, and export-oriented growth would bring about greatly enhanced efficiency; in other words, it would solve the perennial problem that plagued the former socialist economy.

There was, in my view, no alternative to standard macroeconomic policies, that is, to disciplined fiscal and monetary policies, as a means of stopping hyperinflation and of stabilizing the economy. But there were two additional points related to them. First, they had to be supplemented, as already mentioned, by tough wage controls, not only to brake the inflationary momentum, but also because of institutional bias in the labour market in favour of the employees. Second, our enlarged and heterogeneous programme of stabilization had to be linked to the radical liberalization of prices and foreign trade. This was because the task was not only to stop hyperinflation but also to abolish the shortage economy; otherwise no change in the efficiency of operation of the respective enterprises would have been possible.

The structural problem of low efficiency required a fundamental change in the economic system. With Poland's newly gained freedom to shape her institutions, we were no longer condemned to search for a kind of 'third way' solution. Instead, we could now put into place the least imperfect of the real world economic systems, namely, the competitive capitalist market economy. The institutional transformation also included radical changes in the social safety net (for example, introducing mechanisms to deal with open unemployment and strengthening targeted social assistance).

The reasoning was simple:

(i) first, a market economy is to be preferred to a centrally planned economy;

(ii) second, a private enterprise market economy is to be preferred to 'market socialism', since the latter has all the main economic weaknesses of the private enterprise market economy (for instance, a stronger tendency for unemployment), but less innovativeness and dynamism. Hence I firmly believed that we should rely on 'proven models', which we know of from real market economies.

Not everything in these economies had proved itself, and I hoped to avoid the introduction of certain mechanisms which would be difficult to reverse, if not actually irreversible. My major concern was to avoid adopting a Western type of protectionist and overregulated policy with respect to agriculture, especially of the European Community's CAP type, or the sort of industrial policy whereby the state bureaucracy would pick winners by manipulating the tax system or credit policy. State policy with respect to the economy should be as uniform as possible, avoiding detailed intervention. Otherwise a weak public administration would get involved, as in the case of central planning, in widespread bargaining with enterprises about the terms on which they functioned, which would culminate in massive rent-seeking and the same type of soft budget constraint for enterprises as in the socialist system.

I viewed the economic reforms in terms of a radical and comprehensive package, the elements of which complement one another. Within the overall process of economic transformation, I distinguished between liberalization and institutional reform. I knew that the former can be implemented more rapidly than the latter. At the same time, slowing down liberalization and stabilization, in order to enable them to keep pace with the fundamental institutional reform, was for me a more hazardous option than trying to implement all the changes with maximum speed, knowing, however, that stabilization and liberalization had to be largely completed before the institutional framework of the economy could be radically changed.

Within liberalization, the freeing of prices was a crucial measure, necessary for the rapid elimination of shortages and for obtaining better price information. Radical price liberalization required, in my view, a decisive liberalization of foreign trade, which in turn included the unification of exchange rates and currency convertibility. They were also indispensable for obtaining better relative prices. In addition, the fixing of the newly unified exchange rate played an important role in the programme of stabilization, and the introduction of convertibility signalled a decisive break with the past partial and unsuccessful reforms.

Liberalization also included the elimination of the restrictions on the creation and growth of private firms. This was a very important part of a legal framework for economic activity, as it introduced the mechanism of free entry and enabled the spontaneous growth of the private sector. Privatization of enterprises was for me the key part of the institutional restructuring. I viewed privatization as the most important type of enterprise reform, and as the most important condition for enterprise restructuring. The extension of private enterprise was, to my mind, crucial for solving the main structural problem (and of all the post-socialist economies, for that matter): that of low and falling efficiency. But I remembered that the potential inherent in the private sector can be fully released only if there is competition and an outward orientation of the economy. That is why a *liberal foreign trade regime* was for me an important complement to privatization and an important condition for increasing the overall efficiency of the economy. I also believed that some increase in that efficiency might be achieved through foreign trade liberalization, free prices and hardening of the enterprises' budget constraint, preceding the full privatization of state enterprises. However, in order to obtain the maximum possible increase in efficiency, privatization and other changes must be combined.

I viewed *wage determination* as connected to the ownership structure of the economy, that is, to its privatization. The absence of private owners gives rise to an institutional imbalance within the labour market, and hence to wage-push. The intensity of this tendency depended, in my view, on the inherited macroeconomic situation, and on the role and militancy of the trade unions. Both of these factors made wage-push in Poland stronger than in Czechoslovakia and Hungary, and in my view it called for stronger wage controls. An additional reason for these controls was, of course, the inherited hyperinflation. But I was fully aware that any wage controls are imperfect mechanisms for slowing down wage pressure generated by strong socio-institutional forces, and that these controls bring about some microeconomic distortions; besides, the efficiency of wage controls declines over time.

All this strengthened, I believed, the case for rapid privatization, as the only way to remove the institutional imbalance that was generating the excessive wage pressure. But I also knew that the mechanisms of wage determination differed even in capitalistic economies, depending on the structure and the role of the trade unions and on the related properties of the collective bargaining process. This was one of the points I saw as crucial in the Polish situation. Given the 'trade-unionist' tradition of the opposition movement Solidarity, which brought down socialism in Poland, this was a very sensitive point, and I delayed its resolution until the latter part of the economic programme, when it was hoped that there would be many more private employers. But I supported the development of employers' organizations and that of the consumers' movement as countervailing forces to the trade unions.

I considered *strengthening the independence of the central bank* to be a key to stable monetary policy. A law to this effect was enacted as early as the autumn of 1989. The reform of the commercial banks played a crucial role in the general economic reform, and it included setting up new, largely private banks and strengthening the capabilities of the existing state commercial banks.

The tax reform also figured largely in the transformation programme. One of the main directions here was the elimination of the widespread tax breaks and concessions, which were often granted on an *ad hoc* basis. I considered this a necessary condition for the hardening of enterprise 'budget constraints', and the emergence of the market. In addition, tax reform comprised the introduction of value-added tax and of a comprehensive system of personal income tax.

Choosing People and Setting the Rules of the Game

I was aware of the administrative difficulties. I knew that the state's economic administration was rather weak both in terms of numbers and competence, but I also realized that it was not possible to change it quickly for the better because of the shortage of people with adequate knowledge of a market economy and because of the great number of urgent problems. In this situation, I did two things. First, within two or three weeks of taking office, I formed a group of my closest associates, consisting partly of newcomers and partly of insiders, some of whom I already knew. This required me to dismiss some people from their functions in order to make room for the newcomers. With respect to the members of the newly formed economic team, I tried to create a relationship of trust and a sense of common mission. An *esprit de corps* had emerged and was an important factor in keeping the group and the programme together.

Second, I made structural changes to the institutions of which I was in charge. In the Ministry of Finance, we abolished the bloated Department of Prices (responsible mainly for price control) and we created, practically from scratch, the department dealing with financial institutions (banks and insurance companies), headed by a colleague of mine, Stefan Kawalec. We also strengthened the departments responsible for the budget. In my Deputy Prime Minister's office, I created a number of coordinating committees and a group of strategic advisers distinct from those who were dealing with current problems. An important role was played by the section responsible for overall coordination and dealing with the political aspects of the economic programme, that is, with political parties, parliament, office of the president, the trade unions, the mass media, and so on. This section was ably managed by my former student, Jerzy Koźminski.

From my studies of psychology, I recognized the danger of information overload. Therefore, I tried to define the information to be recorded, in order to avoid the overload produced by offices, documents and notes. Many times, unfortunately, I had to ask specific questions and demand certain information, because bureaucrats were only prepared to register the data passively in accordance with the old ways, though the situation at that time demanded a new perspective.

By September I had encountered a technique known as 'muddling through' in bureaucratic jargon. In KERM (Economic Committee of the Council of Ministers), various departments were trying to produce as much paper as possible so as to demonstrate their activity, although, in this new situation, the danger of being completely overburdened was imminent. So I proposed a new principle, whereby KERM would only deal with interdepartmental projects prepared well in advance.

Another, equally important, issue was determining how to treat telephone calls. In all the various offices, there was a tendency to arrange things by phone. 'The clients' thought that by using the phone they would be able to get concessions, because whoever received the call would not be prepared and would agree. I was aware of this danger – particularly in the case of the Ministry of Finance, where many decisions were made – and, because of this, I introduced the rule that there would be practically no *ad hoc* phone conversations with me. My secretaries knew that they were not able to contact me immediately, unless the telephone calls were especially important, for example, from the president or prime minister. Similar rules were created concerning visits and personal contacts – only my closest associates had access to me at any time, if they requested the meeting by phone. However, in the Ministry of Finance, where there were no special permits for visitors issued, people sometimes arrived and demanded to see me immediately. Usually, my secretaries found a way to calm the situation, but sometimes the conversation also involved a security officer. Perhaps it was a coincidence, but both gentlemen from the office of government security had degrees in education and counselling.

Meetings with international visitors formed a special category, in which selection was also necessary. Otherwise, I would have had to spend all my time receiving foreign delegations. In general, I followed the rule that a meeting ought not to be purely ceremonial. I also avoided meetings with particular foreign investors, knowing that one could quite easily become entangled, not being adequately prepared for a particular case. Such matters – and also meetings with domestic investors and entrepreneurs – should be delegated to specialized administrators.

Carrying out one or more meetings or sessions every day, I had to follow strict rules for discipline of meetings. First of all, I announced in advance how much time we had. Secondly, I presented an agenda. Thirdly, on each item on the agenda, I followed a specific procedure: defining the issue to be decided; determining various options; comparing and contrasting the options and, on this basis, arriving at a decision. Comparison was sometimes easy, when one of the variants seemed to be decidedly better than others. It was more difficult when two alternatives were very similar. And frequently, it was not as simple as in decision theory, where one can identify all the variants and put them down to one simple denominator. Usually, there was an element of weighing the criteria, often by intuition. At the beginning, I worked out certain ways to weigh the criteria, being aware that whatever I did was likely to be risky.

In spite of the attempts to rationalize organization of my work, I usually spent about thirteen hours in the office each day. One of my rules was that I did not bring work home. I considered that after a certain point my marginal productivity became negative, which meant that, at a certain level of tiredness, continued reading was a pure waste of effort. It is better, in such instances, to read the next morning when you have a clear mind and can appreciate the argument more sharply, than to tire yourself out by reading into the small hours, only having three hours to sleep. Saturday was usually a working day for me, even though I finished work earlier than on the other days. However, I tried to keep Sundays free, using it to catch up with the newspapers.

In all of my government activities, the techniques which I learned as a researcher were a great help to me: speed reading, directing a research team, and the technique of taking notes.

Preparing the Breakthrough

We set the date for launching the economic programme for 1 January 1990, the first day of the fiscal year. This reason, however significant, was not the most important. We were aware of the fact that, in the face of dramatic changes in other countries of Eastern Europe, after a few months Western countries' interest in Poland would wane. But more important were internal conditions: inflation was soaring and every month of delay deepened the economic chaos. Waiting would increase costs. Precious 'political capital' would be depleted without any economic benefits. I knew the period of 'extraordinary politics' would be short – but it turned out to be shorter than I thought.

The deadline of 1 January 1990 meant that we did not have much time to prepare the necessary laws and get them accepted by the Parliament (Sejm) and Senate, to agree upon a programme with the International Monetary Fund, to prepare executive orders, or to deal with 'ongoing' issues. It was a really trying time.

Some of the people in government circles maintained that it was impossible to do this in such a short period of time. However, in the economic team we did not even contemplate the thought of cancelling the 'zero hour'. In October, the Council of Ministers approved the 'economic programme of government'. However, debates continued and time was running out mercilessly. In the second half of November, I established a special operations group, whose tasks and activities were scheduled daily or even hourly. The last date in this schedule was 31 December, when the president was to sign the accepted statutes.

The work was done on three levels. First, a task force – each run by a deputy minister of the finance or another department – prepared one proposal of a statute. Some members went from one task force to another because they were simultaneously working on several statutes.

The draft laws prepared by these groups were then sent for discussion to KERM. However, before they arrived there, they were generally subject to initial critical review by a small group of key people. The idea was that KERM should receive the final product and not need to spend precious time on long discussions.

The third level was the Council of Ministers which discussed the laws sent by KERM. There were several long meetings. We had to finish before 17 December 1989 – this date was set by the Sejm. The 17 December actually fell on a Sunday, but we calculated that delaying the debate in the Sejm even by one day could endanger the entire programme. We prepared eleven proposals for statutes, essentially changing the legal framework of the economy. They included a new tax law, banking law and foreign exchange law, a law regarding foreign investors in Poland, law on customs, the legal foundations governing credit, and a law on taxing excessive wage increases. From then on, everything depended on the efficiency of the Sejm. To discuss these laws in the normal way would have taken at least several months. Therefore, a special legislative procedure was required.

At the beginning of December, I held a series of meetings with the leadership of the Sejm and the Senate who agreed to support the proposal establishing an extraordinary commission. I also met with the leaders of all the political parties represented in the Sejm and received a favourable reaction to my proposals.

We asked the military to help us print the statutes, and also, eventually, to distribute them to the members of the Sejm, as the capacity of the government printing office might not be sufficient. We were also afraid that members of the Sejm would be scattered all over the country and would not receive the statutes in time – that is, at least a few days prior to 17 December.

'The great unveiling' took place in the Sejm on 17 December 1989. In a speech broadcast on television, I said that the task of transforming the economic system – difficult in itself – had come when circumstances were unfavourable: huge inflation, lack of foreign exchange reserves and the strenuous burden of foreign debt. The tasks which Poland faced were overwhelming and without precedent, and it was necessary to take quick and decisive steps. . .

After the speech, an economic debate ensued and many questions were asked. I grouped them according to themes and distributed them among the ministers and deputy ministers, sometimes writing my own suggestions on where to put emphasis in the answers. Every minister with an economic portfolio had an opportunity to speak. It was an important moment, drawing the economic team together. At the end, I also spoke, giving additional explanation and providing some comments. I had the impression that all of us felt that this was the beginning of something great and important.

The parliamentary session ended that day by creating the 'extraordinary commission'. It comprised dozens of members of parliament from diverse political parties and from various parliamentary commissions. The work of this commission was probably one of the most important and marked one of the better periods of that parliament. Its members later recollected that it was 'a romantic endeavour' when political divisions disappeared. And they worked a dozen or more hours a day, even during the holidays, to get everything ready before the 'zero hour'.

The commission was immediately divided into various task forces working on specific laws. Members of the economic team participated all the time in this work. These task forces worked practically non-stop; the prepared proposals were subsequently sent to the extraordinary commission, where they were analysed and approved.

In addition to direct participation in the work of the commissions, my colleagues watched what was happening in the Sejm. We tried to discover how quickly and in what direction the work was going, so that when problems appeared, we would have enough time to intervene by presenting additional explanations or persuasion. When difficulties or serious deviations from the proposed solution appeared, we intervened immediately.

Parallel with the Sejm, the Senate also worked closely with us. According to the normal procedure, the Senate debates various legal acts only after they are approved by the Sejm. This time, the draft laws approved by the extraordinary commission of the Sejm were sent immediately to the special commission of the Senate which worked on them.

While the Senate and the Sejm were practically in 'constant assembly' we were still engaged in one difficult task: collecting contributions to the stabilization fund from the Western governments. These contributions, of US$1 billion each, were to support the convertibility of the Polish zloty.

The last declarations were still arriving on 29 December. A large number of Western countries promised to provide us with credits or grants, but we had to get them on time. The US Department of the Treasury and, particularly, the Deputy Secretary of the Treasury, David Mulford, turned out to be a great help in mobilizing these contributions. However, delays in making payments occurred nevertheless. I held dramatic telephone conversations, first with the managing director of the International Monetary Fund, Michel Candessus, to whom I said that we were doing everything that we had declared in our programme but that the West was delaying its support for the stabilization fund. Just before Christmas, I was forced to ask David Mulford for help. I phoned all over the United States looking for him. Finally I found him, suffering from 'flu in a Brussels hotel. He received my phone call, and promised to intervene. As a result, a significant amount of the stabilization fund was collected: before the end of December, some $400 million were confirmed and we were assured that the remainder would be available before 7 January 1990.

On 27 December, the Sejm passed the legislative package. The last step required was the president's signature on the statutes. Prior to sending the proposal to the Sejm, I paid a visit to President Jaruzelski. I informed him of the main direction of the economic plan and about the extraordinary legislative procedure. President Jaruzelski told me he supported our approach. We checked the schedule for 30 and 31 December in order to be sure that he would have time to sign all these statutes before the New Year. Knowing that he planned to leave Warsaw for the New Year, we found out what time he would depart. . .

It Works

The first weeks of 1990 were very nervous. We were diving into the unknown. With growing tension, I followed the inflow of information. The first signals were alarming. At the beginning of January, the minister of domestic trade informed us that the reserves of grain, meat and food were low. The minister of agriculture confirmed it. Great pressure was put on me to ask the West for additional food support. I made a number of calls to Brussels, as well as to the United States requesting an immediate supply of food. I had no way of verifying the departmental information because the statistical data were always significantly delayed. I had people observe, see what happened in the shops, and how prices changed. In the first two weeks, we recorded significant jumps in prices, particularly of food products. Unfortunately, it was not followed by a clear improvement in the supply of food. The increase in the price level in January, i.e. corrective inflation, was in fact an element of the programme. We did not know, however, precisely when these price increases would stop. The second goal was to eliminate shortages. Both of these goals appeared to be in danger. On the basis of partial data, we could only surmise. In February we learned – it was an unpleasant surprise – that price levels had not increased by 45 per cent, as we assumed, but by 78 per cent. However, an important positive signal in January was the emergence of street trade. Many farmers decided to sell their produce independently on the streets. Trucks full of goods of industrial products also appeared on the streets. This street trade, even though criticized for its primitivism, played an important role at that time. First of all, it ensured better supply and lower prices than in state-owned stores and, secondly, it created competition for them. Thanks to street sales, shortages quickly disappeared and by February there was already a significant improvement in the situation on the market. At the end of January, the first signs of price reductions were seen; price increases in February were radically lower than in January. I remember how in the second half of January my advisers tried to cheer me up. At least twice they put information on my desk showing that the price of eggs had fallen. I had this checked, but it turned out that the information was patchy. Only one thing was certain about eggs: at the end of January, prices not only levelled, but in certain parts of the country they in fact dropped.

Knowing that after the New Year the economy would be undergoing a difficult transformation, I began to build a more effective system of information-gathering. In late December 1989, I set up several specialized teams. One of the first and the most important was the intervention team. Beginning early in January 1990, this team gathered information weekly and, whenever necessary, even more frequently, and they dealt with almost every possible issue, both current issues and the problems related to systemic reforms. The second group comprised the team monitoring the economy. This team was charged with making a sort of photographic snapshot of the economic situation.

The third group comprised a team analysing public opinion regarding the economy. It was managed by Jurek Koźminski, who in addition was in charge of my staff in the deputy prime minister's office. This team was truly an innovation in our post-socialist administrative system. The representatives of existing and emerging institutes of public opinion and invited journalists as well as managers of departments of the Sejm and Council of Ministers participated in their work. Sociologists and political scientists were also invited.

The Battles to Sustain the Programme

Radical changes in the economy during the first months did not cause serious social reactions. The trade unions were not preparing any dramatic protests. Everybody waited to see what would happen, what would be the real results of the programme of stabilization and liberalization. The situation began to change after a few months. At the end of March 1990, I had my first open confrontation with the unions. The union members came from the Mazovia region. The meeting was stormy. A key topic of this debate was a question I had often been asked before: 'Will society have to bear it all?' Many of those who asked this question emphasized that people were reaching the limits of their endurance.

The main issue, however, focused around the new situation in which the state enterprises found themselves. Moreoever, questions were asked about 'nomenklatura' privatization. It was pointed out that the people who seemed to get rich most quickly were those who had taken advantage of the former system. Another question raised was the likelihood that Poland would become a 'colony' of the West, exporting our raw materials.

A meeting with activists of the Mazovia region turned out to be an invaluable lesson for me in a subsequent serious public test to which I was exposed during an April Solidarity General Assembly in Gdansk.

In the aeroplane I prepared an outline of my speech. On my arrival at the hall, I found already several hundred people gathered and waiting. I was immediately asked to speak. I began by describing the key changes in our economy in the past several months. 'We're at the point,' I said, 'where the continuation of successful economic performance depends primarily on the behaviour of the state enterprises. We have to break away from old habits and attitudes. In particular, we have to stop looking to "the top", to the state, because it is a relic of the old way of thinking. Solidarity has played an important role in removing the old and ineffective economic system, and I am convinced that it will play an equally significant role in the difficult process of creating a new system.' I also said that the role of trade unions should not be taken for granted. There are many different types of trade union. One such type is purely confrontational; but other types also existed: witness the harmonious cooperation between trade unions, employers and governments, for example in Finland, Austria and Sweden. This type of trade union focuses on alleviating the unavoidable costs of modernizing the economy. I wanted Solidarity to be this latter type of trade union.

A flood of questions followed, which I did my best to answer. I was asked whether energy prices would increase. Members of the audience demanded that a debate be held on alternative economic programmes. They complained that the mines could not export their products independently. There were also questions about state aid for families, support for privatizing enterprises and the process for replacing higher level management. One man asked whether I was aware of the hostility towards me among such groups as the retired, teachers, and health-care workers. I replied that I was aware of the unavoidable price that all members of society had to bear in the transition to a market economy. Many people expressed concern about unemployment. I explained that hidden unemployment, which had existed before 1989, was becoming open unemployment.

The year 1991 started with conflict over wage controls. This was one of the side-effects of the presidential campaign of autumn 1990, during which taxation of excessive wage increases was sharply criticized. The trade unions wanted to use the change of government to extract concessions on this matter. Negotiations with these unions were difficult, because I did not see any possibility for concessions. Normally, in every negotiation, one has to have some position from which one can pull back if the pressure is too high. Here, however, movement was limited. Simultaneously, it was clear that the trade unions had to 'get something' in order not to return home empty-handed. In such situations, one usually forms a task force to maintain the negotiations hoping that a compromise will be found. We created such a task force, but devising the agenda was harder.

On the first Monday of February 1991, President Lech Wałęsa, who had succeeded General Jaruzelski in 1990, was due to speak live in a Polish radio phone-in broadcast. I decided to visit him in his presidential office at Belweder, just in case the wage tax was brought up. It was clear that radio listeners would be asking him about this; the tension among employees was very high. The issue, as it turned out, was the starting point for our conversation. We also talked about types of leadership. I mentioned the example of a former president of Argentina, Raul Alfonsin, who was elected as a popular chief of state. He followed a short-sighted economic policy which caused rapid deterioration of the economic situation. As a result, he had to leave his own government in disgrace.

I think that to some degree as a result of my visit to Belweder, during the next meeting with radio listeners, President Wałęsa not only did not support eliminating the wage tax, but also formulated the famous sentence that it was necessary to lower costs and prices – by 'fifty or even by a hundred per cent'.

When the battle over '*popiwek*' (the tax on wages) slowly began to subside, another conflict emerged. More and more frequently there were signals that protest was about to begin in rural areas. I think that to some degree this resulted from the presidential campaign in 1990, which had increased farmers' expectations. For a whole year farmers had met increasing difficulties in the world of new economic reality. They demanded guaranteed minimum prices for agricultural products, low interest rates on credits, and more and more protection at the borders. In addition, there were increasing strikes of workers on state agricultural farms.

From the very beginning, I was of the view that agriculture should not be excluded from the reform process, even though farming is special. However, from the beginning, there was strong pressure from the farmers for high customs barriers and duties on agricultural products.

Another frequently repeated demand from the farmers, which I resisted, concerned preferential credits which farmers had been used to in the past. In general, I considered that the radical approach of pro-agricultural activists resulted not only from the great difficulty being experienced in the rural areas, but also because of the competition between various political parties for the farmers' votes. Experience in other countries has shown that farmers have a bias towards radical movements, maybe because, in contrast to workers in industry, they do not risk losing their jobs. From observing the European Community, I also recognized the harmful effects of artificially increased agricultural prices and the difficulty of moving away from such a policy. It was very important for me not to commit the same mistake. With respect to production, private agriculture adjusted rather well to the economic programme. However, taking income level into consideration, farmers really did experience deterioration, particularly in 1990, because in 1989 they had obtained large windfall gains. In 1989, prices of agricultural products after liberalization increased significantly more quickly than prices of industrial products purchased by farmers, which had not been decontrolled. Thus, what farmers gained in 1989, they lost in 1990, when price movements were reversed. In addition, in earlier years, farmers had been provided with ample cheap credit. This changed in 1990.

Thinking about agriculture, I realized that we were facing both a great problem and a great opportunity: a higher percentage of the population was employed in agriculture in Poland than in other countries, for instance, in Greece or in Spain. This was a factor which could accelerate growth if we could move significant numbers of the less productive labour force in agriculture to more productive sectors of the economy.

With hindsight, one can see that the Polish political calendar was not very opportune. The political construction of the 'Round Table', a pioneer development in 1989, unexpectedly quickly turned out to be a liability. In Hungary and Czechoslovakia, by the first stage of the process of departure from the previous system, new elections were called. This gave both countries the higher political stability necessary for economic reforms. In Poland we had the reverse sequence: first there was a radical economic programme for the economy and only then the successive dismantling of the 'contractual political system'. In addition, dismantling was taking place in the reverse order: we began with presidential elections, while parliamentary elections were moved to the end of 1991. In the years 1990 and 1991, we had two electoral campaigns and we changed government twice. Even in countries which have a stable economy, political tension caused by election campaigns may have a negative influence on the economic situation. All the more reason to be concerned for a country which was undergoing a massive process of social and economic transition. In addition, the more the economy is state-owned, the more susceptible it is to politicization. Even during the presidential campaign of 1990, the economic programme caught the attention of most of the participants. I was concerned that during the forthcoming parliamentary campaign in 1991, even more tension would be caused by populist slogans.

However, until mid-1991 cooperation with the Sejm worked quite well. By giving enough explanation and persuasion, I was able to obtain the support of a majority of the Sejm for the proposed economic legislation. The best period from this point of view was December 1989 when, with immense concentration and mobilization in parliament, it was possible to pass the package of statutes which formed the new economic programme on 1 January. In spite of tension between the government and the Sejm, we were usually able to find satisfactory solutions.

The Foreign Debt Reduction Campaign

Foreign debt was one of the largest burdens on the Polish economy inherited from the socialist era. In September 1989 I was certain that Poland would not be able to eliminate galloping inflation, change its economic system and simultaneously service the large inherited debt. It was clear that the problem of our debt had to be solved by a triangle: Poland, the International Monetary Fund, and the creditors officially represented by the Paris Club and more that 500 Western banks, known as the 'London Club'.

Poland's debt had grown during the 1970s and particularly in the second half of that decade. In 1975 it was already more than $8 billion and in 1980, $25 billion and, by the end of 1989, approximately $41 billion dollars. From the credits obtained in the 1970s, only 20 per cent had been utilized for investment purchases, while 65 per cent had been devoted to importing equipment and materials, and the remaining 15 per cent had been spent on consumption imports. Poland was at that time a huge net importer of food products (the situation turned around in 1990, when we became a net exporter).

Almost two-thirds of Polish debt was in the form of credits guaranteed by Western governments. The second largest group of creditors was formed by the 'London Club'.

As early as 1981 a very sharp balance of payment crisis had emerged in Poland which prevented the service of debt. For the first time Poland had requested restructuring of debt or a moratorium on payment of debts. In April 1981, an agreement was signed with the Paris Club that postponed 90 per cent of repayment for the four years 1986–89 on the capital, but simultaneously obliged Poland to repay the interest. The imposition of martial law led to the Western representatives severing ties with the Polish government. As a result, Poland did not service any debts for several years. However, commercial banks represented in the London Club did not break off relations and as a result they came to an agreement regarding debt restructuring. In this way Poland shifted the burden of debt to later years. It eased the situation in the short run. However, during 1988–89, it turned out that even this significantly reduced payment obligation was far too high in relation to the payment abilities of Poland. On 15 September, or three days after I took office, I became aware of discussions and negotiations with commercial banks regarding our debts to them. We were not able to service the debt by the date agreed earlier. We had dramatic debates with representatives of some Polish banks. We were forced to mobilize our modest financial resources to pay foreign banks. Simultaneously, we agreed that we would produce only 15 per cent of the interest due and that 85 per cent of the interest would be repaid at a later date.

In September 1989 we estimated that Poland was short of some US$500 million necessary to cover essential imports. Therefore, during my first meetings with finance ministers from Western countries at the end of September 1989, I presented them with a request for emergency credit of almost US$500 million in order to avoid serious economic upheaval. I was able to obtain credit by December 1989 – US$215 million as a so-called 'bridging loan' from the Bank for International Settlement in Basle. The rest were short-term credit guarantees from the West. It was not until 1990 that we achieved a high surplus in the trade balance and the balance of payments crisis disappeared.

We were aware that without agreement with the IMF on the economic programme it would not be possible to obtain any satisfactory solution to Poland's debt problem. Therefore, for the whole of that autumn there were intense negotiations which ended in December with a mutual agreement, the so-called 'letter of intent'. This document stated that Poland would strive to obtain full relief from payments of both capital and interest in 1990. In addition, the document stated that Poland intended to conclude an agreement with creditors on the permanent reduction of the debt burden. Then many months followed in which we worked strenuously to obtain support for this unconventional solution. The main problem was that the essential debt reduction, mainly debt owed to the Paris Club, had no good precedents.

The agreement with the IMF paved the way to an agreement with the Paris Club in February 1990. In it we obtained full debt relief from all payments until March 1991. This gave us time to pursue our efforts to reduce the debt burden. An agreement with the Paris Club opened a way for foreign credit guarantees.

In January 1990, Prime Minister Tadeusz Mazowiecki sent a letter to creditor heads of state requesting a debt reduction. It did not bring any direct results, but it certainly was an important element in the whole scheme of things. We waited several months and in May 1990 I decided to take the next step. It was at the time of the interim committee meeting at the IMF in Washington, DC. All the ministers of finance from the West took part in this meeting. I proposed the plan for debt reduction whereby Poland would have to pay no more than 2 per cent of its total debt per annum, and the growth of the debt would be arrested. This would correspond to debt reduction by some 80 per cent. Today, I do not have to hide the fact that the extent of the proposed debt reduction was dictated by negotiation tactics. The first step in negotiation had to be proportionally bold.

Our proposals were obviously received without enthusiasm. Immediately after my speech we began an explanatory campaign. Soon afterwards, I held a series of meetings with the ministers of finance from the United States, the United Kingdom, France, Japan, Germany and Canada, as well as representatives from the Senate and Congress of the United States. The ministers were rather reserved in negotiation and they avoided specific commitments. The degree of their restraint, however, varied. The Japanese delegation was the most reserved during the meetings. By contrast, the representatives of the United States were the most favourable during the period of subsequent meetings and discussions. The conversation had a specific structure. In the beginning, I briefly presented the internal programme of Poland's reconstruction, what we had done, what we planned to do, and against this background, the external conditions necessary for the success of the Polish reforms. Here we presented a proposal to reduce the debt. I always spoke without an interpreter in these discussions, which made the conversation more natural and allowed direct contact with my counterparts. I said that we not only had to reduce financial obligations which were associated with servicing the debt, but also we had to reduce the debt burden itself. The second was necessary, I argued, to reduce uncertainty, which was detrimental to the investment and political climate in Poland. No one directly questioned my arguments. If there were any questions, they usually related to reform issues: what had we done? what were we planning to do? They let us know clearly that some exceptional conditions had to exist in order to obtain exceptional debt relief.

I used all of my foreign trips after May 1990 to lobby for debt relief from the creditors. In June 1990 I went to Germany where I met with Chancellor Helmut Kohl and with the minister of finance, Theo Waigel. Chancellor Kohl attentively listened to my arguments regarding reducing Poland's debt. Visits to Washington followed in September 1990. The United States was suffering from a budget crisis and some state employees had not received their salaries on time. I appreciated all the more the fact that leading politicians found time to meet me. I met President Bush, telling him what we were doing in Poland and how important the debt reduction was for us. Then I spent 18 and 19 October in Rome. I met the prime minister, the minister of finance and the minister of foreign affairs. Prime Minister Andreotti clearly stated that he would support Poland's desire to obtain debt reduction. I was very pleased to hear that. Minister of Finance Guido Carli was more restrained and began the conversation by painting a dramatic picture of the Italian finances. As a matter of fact, they had a deficit totalling 10 per cent of GDP and an unstable political situation. I told him that I knew what it meant to limit public expenditure and that Italians certainly ought to understand why we tried so hard to reduce our burden of debt. However, the conversation was very difficult. The next day I was received by the Pope John Paul II. The conversation with John Paul II lasted almost forty minutes. The Pope was cordial and direct. He asked whether it was possible to create a just market economy in Poland. He also asked me about the economic situation in the country. Of course, I presented the problem of Poland's debt and our efforts to reduce it.

In Warsaw, I received ambassadors from creditor nations and various foreign delegations which had arrived in Poland. No matter what topic we discussed during the conversation I always repeated my theme that debt reduction had to go forward. At the beginning of 1991, as part of our 'debt release offensive' President Wałęsa sent a letter to leaders of most of the industrialized countries in the world, the G-7. After meeting in the United States in January 1991, the G-7 issued a communiqué in which they stated that the problem of debt would be dealt with. To me, that was a great step forward.

The beginning of 1991 was a real race with time: in March, the agreement with the Paris Club, signed in February of 1990, on the basis of which we were not required to service our debt, was going to expire. We knew we needed to find a new solution and a new agreement – again we wanted to have a clause about debt reduction. However, in order to get to this point we needed to sign a standby agreement with the IMF, which was a precondition for passing the budget in the Sejm. The debate on the budget in the beginning of 1991 was delayed. We were in a hurry, however, and therefore the tone of my speech during the parliamentary debate on the budget seemed 'dramatic', as was later commented. I felt that Poland's political honeymoon was rapidly fading. It was the last opportunity to play on the exceptional nature of the Polish situation in order to obtain foreign debt reduction.

In this context, there was a very important visit to Poland on

6 March 1991, by the deputy secretary of the US treasury, David Mulford, who was considered the chief 'operator' on world debt issues. Mulford was unequivocal: 'Your request for 80 per cent of debt reduction is unrealistic. If you stick to it, your efforts may fail entirely. It may be realistic to get a maximum reduction of 50 per cent. You might be able to count on slightly more if you obtain acceptance by creditors. But here, we would have to persuade Japan to agree to the debt reduction. I may try to persuade them of a 50 per cent reduction; however, I am not able to fight for more,' said Mulford. We had to take a position. Our group concluded that Mr Mulford was right. We agreed that 50 per cent was quite a lot.

Mulford's visit was an important stage of preparation for President Wałesa's trip to the United States. Americans were concerned that the president might again discuss the issue of the lack of positive response from the West. We wanted to have our agreement before his visit to Washington. Before Mulford left Warsaw, he met the president and prime minister and repeated the US position on the 50 per cent debt reduction. In Paris on 14 March 1991, there was a meeting of a working group of creditors during which there was a public announcement regarding debt reduction rules for Poland. That was a watershed. The press communiqué announced that the creditor countries were aware of the exceptional situation in which Poland found itself while engaging in an unprecedented transformation towards a market economy. These countries expressed their willingness to reduce debt – utilizing various mechanisms, 50 per cent of the net present value of Poland's debt towards the Paris Club in two phases, 30 per cent in the first phase and 20 per cent in the second phase, provided that the IMF agreement were successfully completed.

Some discussions and debates dealing with technical issues were very important, and we had some nervous moments before the agreement was signed, on 20 April. The Polish delegation with Janusz Sawicki was in Paris to negotiate with representatives of the Paris Club. The delegation was in touch with the task force organized by me at the National Bank of Poland (NBP). We received faxed pages of the proposed agreement and after discussion we made corrections which we faxed back to Paris.

Trips to Moscow

During the summer of 1991, there were negotiations on a meeting with Mikhail Gorbachev who had expressed interest in discussing the Polish economic reforms. The visit was scheduled for the early part of August and a few days later the Polish ambassador to Russia, Ambassador Ciosek, informed us that at that time there would be an important plenary central committee meeting in Moscow which might be decisive for the future of the Soviet Union. We decided therefore to postpone our meeting until the end of August when Mr Gorbachev would have returned from vacation. In Warsaw we were haveing a heated debate in the Sejm when suddenly the news came from Moscow of the 'coup' which had removed Gorbachev from power. It seemed that any visit to the Soviet Union, would not be in the near future. But later the leaders of the coup were placed under arrest and information arrived from Moscow confirming the government's interest in my visit there. On 2 September, I found myself on the plane to Moscow. The official host was the Russian government, and an individual meeting with Gorbachev was scheduled. When we landed, it turned out to be much more complicated. It was not always clear who was represented by whom and many people in the Russian cabinet were simultaneously performing various functions in the Soviet apparatus. This was the case with Ivan Silajev, the Russian prime minister, who was simultaneously performing the function of chairman of the committee for current management of the Soviet economy. Conversations were held in an atmosphere of high uncertainty. Literally in front of our eyes, in place of the Soviet Union, a new, but not yet very well-defined state was emerging.

There was an unpleasant incident. Just before the press conference in the Polish embassy, I was told that a moment earlier Prime Minister Silajev had given a live television speech in which he said that Poland wanted to participate in the newly formed Economic Commonwealth – an economic successor to the Soviet Union. Furthermore, he said that he had personally received this information from Mr Balcerowicz, currently in Moscow. I felt myself go cold and then broke out in a sweat. During the meeting with the press, there was of course a question about my reaction to Silajev's statement. I responded that I did not know anything about this statement and that I had certainly never endorsed Poland's participation in the community.

After the conference, embassy employees ran to me with notes sent by major press agencies which were already citing Silajev's statement that 'author of Polish reform L. Balcerowicz expressed an interest in having Poland becoming a member of the [Russian] community'. I could imagine such a communiqué being received in my country: Balcerowicz wants to annex Poland to the Soviet Union . . . The mayor of St Petersburg, Mr Anatoly Sobchak, came to my aid. He went to Silajev and persuaded him that he should issue a retraction, and so Silajev called a late evening press conference where he publicly expressed contrition.

Then, as had been planned, I met with Boris Yeltsin. The next day I talked with Mikhail Gorbachev during a lunch break. Gorbachev appeared to be relaxed, but acted very vigorously. He said it would be a historical paradox if problems emerged in Polish–Russian relations just as the Soviet Union was interested in discovering the Polish path to economic reform. As we said goodbye, he said he would like to meet me in the near future for a longer time and discuss economic reform.

However, on my next visit to Moscow, in December, I only talked with Yeltsin. This second visit had its own history. At the beginning of November 1991, Sergei Stankievich, Yeltsin's personal representative, arrived in Warsaw to convey the invitation of the Russian president to Moscow for a 'meeting of leading world economists'. I decided to go, as long as I could also negotiate a trade agreement with Russia. This was eventually accepted by the Russian side.

My trip was scheduled for 9–11 December. But at that time the prime minister resigned and I took over the function of running the government. On 7 December, in Białowieża, there had been a meeting of the presidents of Russia, Byelorussia and the Ukraine which laid the groundwork for the dissolution of the Soviet Union. Tremendous changes were taking place in Moscow. We did not know whether to go to Moscow or not, whether the announced meeting of economists would take place or whether we would be discussing the specifics of Polish–Russian trade agreements. We decided to postpone the visit, and eventually departed on 18 December.

At the airport, I was greeted by Konstantin Kagalovski, an adviser to Prime Minister Gaidar. I had met Kagalovski along with another radical economist, Yavlinsky, in the fall of 1990 in Warsaw, when they had come to study the Poland's experience of economic reform.

With Gaidar, we spoke first of all about the initial economic situation in Russia and the planned Russian 'shock therapy' and compared it to the Polish situation. The Russian deputy prime minister remarked that Russia might have some advantages over Poland because there was more discipline and stronger management in Russian enterprises than in Poland. Then he described the main premises of the Russian reform programme. I agreed with Gaidar that galloping inflation and vast shortages cannot be abolished gradually. There has to be an anti-inflationary shock and severe repression of demand by limiting the supply of money from various sources. And of course there has to be price liberalization.

The Russian stabilization plan differed significantly from the Polish one in at least two aspects: it did not include wage controls of any sort, and it introduced a flexible rate of exchange for the rouble (instead of a fixed one). One could say – indeed Gaidar confirmed this himself – that their stabilization programme was much more orthodox than ours was. The monetary restraint was to be the only anti-inflationary barrier. Enterprises granting excessive wage increases would basically face bankruptcy, and their workers, unemployment. In our programme, there were two additional lines of defence – brakes on wages, and the fixed rate of exchange which should have calmed inflationary expectations. By January 1992, it turned out that there was another significant difference in the programmes: the liberalization of prices in Russia was much more limited.

The culmination of my visit to Moscow was the meeting with Boris Yeltsin. The conversation with him was held in the Kremlin in the former office of the secretary of the Communist Party of the Soviet Union and lasted approximately an hour. Yeltsin spoke quite a lot. He said that he had made up his mind to create a community of independent states and that in the new construction there would be no room for Mr Gorbachev. Speaking of the approaching date for price liberalization, he asked me whether I thought that prices would double or treble, as the economists argued, or increase tenfold, as he himself feared. He asked me when one could expect improvement in the form of more commodities on the shelves.

I told him that, based on our experience, it was better to err on the side of pessimism. We had also had some very nervous moments in January 1990 when it became evident that the jump in prices was much larger than we had expected and when it turned out that the decline in production was deeper than expected. There are two stages in the process of departing from a high-inflation shortage economy, I said. The first is 'market revolution'; it requires a rigorous macroeconomic policy and massive liberalization of the economy. The second stage consists of changing enterprises and other institutions – this takes much longer. The key political question is how to maintain support for reform in the second phase when most of the good things (full shelves, stabilization of prices) have been achieved, but there is still a need to continue the painful restructuring operations. Such natural dynamics of economic reform create problems because people take the gains from stabilization and liberalization for granted and resist the pains of the second stage of reform. It is difficult to explain that increasing real purchasing power may be only gradual and, moreover, conditional on restructuring the economy. Serious problems tend to emerge, particularly in large state enterprises, which require massive change but are used to the old ways and retain political power.

At the end of the conversation Yeltsin said (I reconstruct from my notes):

> We are concerned about how society may react to the price liberalization. We are determined to do it in spite of the very meagre reserves of commodities in the market. Though there is credit and humanitarian aid from the West, it is small compared with the great needs of Russia . . . We have been criticized because this critical operation is led by an inexperienced, young team but their youth and dynamism is an asset, in our view. To support those young ministers' reform, I am ready to risk my own position. Gorbachev did not have the chance to implement such bold and unpopular reforms. With his low public support that move would have been political suicide. We will part with Mr Gorbachev in a civilized European way, as you did with Mr Jaruzelski. Each of us has to face a departure from the political scene. We are following the Polish reforms with great interest and are open to your advice and propositions. We are very much interested in cooperation with you. This is for us the most difficult moment since the end of the Second World War. Whichever way our reform goes, whether in victory or defeat, will be relevant for the entire world . . .

I left proposals of cooperation without giving a specific answer. The function of a regular adviser could not really be considered, although I was very interested in the Russian reform and I was willing to maintain contacts.

After meeting Yeltsin, there was a press conference for Mr Gaidar and me. Quite aggressive journalists' questions addressed to Mr Gaidar reminded me of my experience in Poland. For example, what will happen to cultural institutions, which, it was implied, might collapse? I was asked about similarities and differences between Polish and Russian economic programmes.

The Final Days

On 6 December, 1991, during the swearing-in of Jan Olszewski as new prime minister, I was at the Sejm. I congratulated the new prime minister and we agreed to meet at the Council of Ministers later that day. Olszewski asked me to run the cabinet until the new government had been formed. I, for my part, presented him with the major issues and general problems which the new government would be facing. We held several other meetings later on. Subsequent cabinet meetings were devoted to resolving the discussion of the preliminary budget proposal for the first quarter of 1992. The discussion regarding the draft budget began at the end of November but did not end in any agreement. As usual, when discussing budgetary issues, ministers spoke about the 'absolute minimum' for their departments, painting catastrophic pictures of what would happen if they were to receive less than that. I stressed the need to maintain the budget deficit within the specific limit; we returned to the budgetary debate in December. The discussion went according to the usual schedule: that means, it commenced with an appeal to increase expenditure. During the intermission I invited members of the Council of Ministers to my office and I offered them some small increases in allocations which were within the modest reserve framework that we had at our disposal. I knew that this provisional budget had to be accepted and there was no possibility of constructing a better one. I also knew that there was little time for further discussion. My proposals were accepted when we returned to the official room and the budget proposal was quickly approved.

From my first meeting with Prime Minister Olszewski, it was clear on both sides that I would not be participating in a new government, even though that was never mentioned directly during our conversations. Some potential candidates for the position of minister of finance asked me for advice. Thanks to my experience, I had a clear picture of what characterized a good finance minister. It was not enough to know basic macroeconomic truths such as that the deficit must be limited, that money should not be too easy and and that it is impossible to lower interest rates when inflation is too high. What really counts is the ability to organize a good team capable of resisting pressure. Every minister of finance is the subject of incessant pressure for increasing expenditure – and sometimes a dramatic one. Moreover, a finance minister must be alert because at any moment there may be a proposal from any side directly or indirectly leading to higher expenditure. In my opinion, the selection of an inappropriate candidate for the position of finance minister would threaten the stability of the economy. However, in no way did I intend to interfere in the process of forming the new Cabinet. I wanted the new government formed as soon as possible. I could not imagine that the provisional situation would continue for long.

On Monday 23 December, the Sejm approved the new cabinet. That evening, I met with the prime minister and presented him with information regarding the most essential economic issues and decisions which needed to be taken by the new government. The next morning, Christmas Eve, I visited the Council of Ministers' building for the last