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Economic transition in Poland: the relevance of the Latin-American experience

Transição econômica na Polônia: a relevância da experiência latino americana

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RESUMO: A terapia de "shock" foi usada na Polônia ocasionando muitos problemas. É verdade que quatro anos depois a economia voltou a crescer, mas a transição à economia de mercado realizou-se com taxas altas de desemprego e crescentes desigualdades sociais. O programa de liberalização e estabilização econômica da Polônia tem muito a ver com programas similares experimentados na América Latina e poderiam ser úteis à Polônia. No curto prazo os custos são parecidos aos da experiência latino-americana. Ainda que a estabilização tenha sido obtida parcialmente, os custos sociais deslanchados foram grandes, fazendo com que a continuação de reforma econômica fosse politicamente indigesta no contexto democrático.
PALAVRAS-CHAVE: Economias em transição; liberalização; estabilização.

ABSTRACT: Shock therapy was used in Poland causing many problems. It is true that four years later the economy started to grow again, but the transition to the market economy took place with high unemployment rates and increasing social inequalities. Poland's liberalization and economic stabilization program has a lot to do with similar programs experienced in Latin America and could be useful to Poland. In the short term, costs are similar to those of the Latin American experience. Even though stabilization was partially achieved, the social costs that took off were large, making the continuation of economic reform politically indigestible in the democratic context.
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The rapid changes that have been taking place in Eastern Europe and the former Soviet Union, especially the dismantling of state industries as these countries

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enter the market, have underlined the extent to which distortions in the old Soviet-type command economies made those systems unworkable. In their place, strategies pursuing market-oriented restructuring have aimed at breaking decisively with the socialist system, at ending piecemeal reform, and at making a "jump to the market" (Sachs, 1993). These strategies associated with neoliberalism assume that once the economy is deregulated and privatized, it will produce well-functioning markets. However, unexpected difficulties and economic complexities have made the transition more complicated than many western advisors had anticipated.

After nearly five years, stabilization, liberalization, and privatization, the central tenets of a neoliberal shock treatment, have made the Polish economic transition relatively successful, certainly compared to other post-communist economies. In sum, there was a restoration of economic growth after the third year, hyperinflation was brought under control, the private sector grew rapidly, Poland's creditworthiness was restored, and shortages were eliminated. However, on the minus side, the transition in large measure also resulted in a sharp rise in unemployment, worsening social inequalities, and a heavy reliance on and subordination to western capital (Elliot & Dowlah, 1993; Darton, 1993; Engelberg, 1992a; Kilmester, 1992; Leven, 1993).

This paper is a comparative study of economic reforms in Poland and Latin America. It tries to analyze economic reforms across economic and political settings and examines their respective outcomes. It explains what the political difficulties have been in the face of growing hardships for broad sectors of its population. It discusses the Polish economic transformation since 1990 and the possible lessons that could have been learned from the Latin-American experience.

Latin America's experience with stabilization and structural adjustment is insightful and instructive to the Polish economy. Some of the relevant issues are: (i) achieving economic reform in the context of intensive indebtedness and weak market economies, (ii) making structural adjustments in state-dominated economies where market mechanisms were constrained or suppressed, and (iii) implementing economic reform which requires enormous social costs. Both Poland and Latin America have experienced economic crises and the outcomes of policy reforms to date have been strikingly similar (Graham, 1991; Bresser-Pereira, 1994; Messner & Meyer-Stamer, 1994). To deal with their crises all these countries adopted shock treatment type of stabilization and structural reforms. The shock therapy program introduced in January 1990 in Poland has much in common with similar programs attempted throughout Latin America in the mid- l970s and 1980s (Lipton & Sachs, 1990; Corbo, 1992; Pastor, 1987; Solimano, 1992). Although it is difficult to foresee the long-run outcome in Poland, the high short-run costs are consistent with the Latin-American experience (Slay, 1991b; Nelson, 1993).

As has been the case in Latin America, Poland also faces the risk of failure due to the unwillingness of the population to tolerate prolonged stringent reforms, and the related danger of a government that at times has been tempted to resort to autocratic rule to keep reforms on track. Latin America's promotion of the market has not been analogous to democratization (Przeworski, 1991; Bresser-Pereira et al., 1993). This is particularly the case in Chile and Mexico, which are heralded as the most successful examples of economic reform in Latin America.

My argument is not that authoritarianism is immanent or based on the prediction of the failure of neoliberal economic reform in Poland. Rather, I am suggesting that in Latin America the concentration of power in the Executive (with clear authoritarian overtones) has been characteristic of neoliberal reforms, particularly in Chile, Mexico, and Peru. In the more established democracies, such as Venezuela and Costa Rica, neoliberal reform has tended to falter or fail (Naim, 1993; Hansen-Kuhn, 1993). In Poland, in the face of political reaction from below, delays have occurred and resulted in a softening of reforms.

This paper argues that neoliberal economic policies in Latin America have only achieved modest success in the area and have not performed as initially forecasted in Poland. Neoliberalism differs significantly from the methods which gave rise to growth and prosperity in the world's successful market economies. The advocacy of a "minimalist state," for example, ignores the fact that almost all of today's strong economies developed under states which played active roles in fostering and protecting economic activity. Although free-market reforms supposedly entail a dramatically reduced state from the economic arena, in reality they also require a strong state to enforce measures that have high social costs. Thus, while democracy may require capitalism, capitalism does not necessarily require democracy. Hence, far from being a natural partner to democracy, as Przeworski (Bresser-Pereira et al., 1993) argues, neoliberal reforms tend to endanger democracy.

The argument here is that transitional pains are not necessarily brief, and the consolidation of democratic institutions can easily be undermined under such conditions. The pattern so far shows that it is authoritarian regimes that have been more capable of imposing and preserving shock treatment programs.[1]

The shock therapy program in Poland held during the first year but thereafter was made less stringent. According to Murrell, "when the realization hit that the shock was not going to produce some magical effects, the program came under severe attack. Gradually many of the elements of the initial program were withdrawn or weakened" (1994, p. 129). In 1991 there was a movement away from shock therapy in the face of open opposition to the government's policy. The basic dilemma of the policy has been that it is not enough for an economic program to be coherent and economically feasible to stand a chance of implementation, but it must also be politically appealing.

[1] Perhaps the exception or atypical case is that of Czechoslovakia (now the Czech Republic) where voters have kept Prime Minister Klaus (a shock therapist or neoliberal) because his government delivered the region 's lowest rate of inflation, as well as trade and fiscal surplus. The exception of the Latin-American case is that of Argentina, where the democratically elected government of Menem has carried out a tough program of economic reforms. Menem was elected to another term in May 1995.

ESTABLISHING THE VALIDITY OF COMPARISON

Poland (as representative of Eastern Europe) and Chile, Mexico, and Peru (as representative of Latin America) are not entirely comparable entities. They differ in terms of level of economic development, the degree of economic problems, degree of inequality in distribution of income and wealth[2]; and in the weakness or lack of a legal and institutional framework for a smoothly operating market. However, based on such indicators as per capita GNP, the sectoral structure of the economy, or the capacity to service its foreign debt, both areas have some degree of commonality.

The justification for choosing Poland is that it was the first East European country to embrace shock therapy and shift from central planning to a market-based economy. The Latin-American countries have also had very centralized economies and have adopted radical programs of stabilization and structural adjustment. Despite the different approaches – and circumstances -there are important similarities between Poland and Latin America. The similarities are as follows: past development strategies had reached their limit and showed signs of economic decline and stagnation, strong state intervention and highly protectionist economies, problems of inefficiency and inability to compete internationally, high level of foreign indebtedness, the degree of dependence on outside economic links (for Latin America the USA and for Eastern Europe the former USSR), and a transition from authoritarian rule to democracy (Slay, 1991b; Corbo, 1992; Killick & Stevens 1991; Nelson, 1993).

In varying degrees Poland has confronted problems similar to those of Latin America as it embarked on a painful economic transformation. Despite qualitative improvements (free press, parliamentary democracy, the disappearance of shortages, improved quality of service), official data shows a drop in living standards for some sectors of the population until the end of 1993.[3] The disregard for worsening social conditions that result from neoliberal policies is at odds with the need for a safety net to mitigate the instability these conditions produce.

[2] A basis for comparison between Poland and Latin America is that Poland' s GNP per capita is about the level of a middle-income developing country. It is poorer than all the West European countries but is on a par with Argentina. Furthermore, its sectoral share of GNP is similar to Argentina. As debtor, Poland ranks just after the biggest three Latin-American nations. On the macro level Poland and Latin America have experienced similar difficulties and problems of economic stagnation: accelerating rates of inflation, falling productivity, and huge budget deficits.

[3] As real incomes continued to drop for the first three years, infant mortality increased between 1989-1993, public health deteriorated (aggravated by the use of alcohol and cigarettes), the death rate increased, and the incidence of crime also increased. See Unicef, 1993.

THE LATIN AMERICAN EXPERIENCE

As Eastern Europe started its incursion into the market, a number of Latin American countries already were embracing neoliberal reforms and allowing market forces to flourish free of government restraints. After 1982, but particularly in the second half of the 1980s, the region witnessed a great ideological shift toward market liberalism when several Latin American countries adopted economic policies which established a new economic orthodoxy (Foxley, 1983; Ramos, 1986).

Neoliberal restructuring policies became an important departure from previous economic policies and a populist past. In the decades of the fifties, sixties, and early seventies, the state was viewed as a solution in times of crisis; today it is looked at as the very problem causing the crisis. The aim today is to reduce significantly the role of the state in the economy and allow market mechanisms to allocate resources. The core of this economic policy reform has been exemplified by the pursuit of financial liberalization, privatization, fiscal austerity, competitive exchange rates, lower import taxes, and deregulation of foreign direct investment.

During the 1980s Latin-American countries experienced recession and a devastating depression (Handleman & Baer, 1989; Rosenthal, 1989; ECLA, 1990). Essentially, lower prices for commodity exports, decreased investments, and growing financial burdens imposed by the international debt created the economic parameters of the crisis. Output per capita dropped 15% during what Latin Americans called the "lost decade". On average, per capita income was below 1975 levels. In some countries real wages dropped by as much as 50%. Most countries in the continent were experiencing high levels of external indebtedness ($417 billion in 1990) and some were faced with worsening internal economic and social conditions. Table 1 depicts some of these indicators for this period.

Despite the obvious variations and pace of implementation there are strong similarities in the neoliberal projects that have been implemented. Countries such as Chile, Mexico, Argentina, Venezuela and Peru have been selling government-owned businesses, cutting budget deficits, lowering tariffs, substantially reducing food subsidies, and opening the door to foreign investment.

A key aspect of these market-oriented reforms is privatization. From 1982 to 1992, Mexico sold or dissolved 935 of 1,155 government-owned companies (Volje & Draaisma, 1993). Between 1974 and 1989 Chile privatized 550 state-owned enterprises, producing nearly a quarter of Chile's value-added (Luders, 1991).[4]

[4] The process was concentrated in two rounds, the first covering 1974-1978 period, and the second, 1985-1989. Emp1oyment during the first round was reduced from 161,000 to 90,000. The process was swift, in 1974 alone 325 firms had been privatized.

Table1: Selected economic indicators for Latin America 1981-1989
(average annual growth rates)

GDP *per capita*	-1,1
Income *per capita*	-1,0
Consumption *per capita*	-1,1
Investment *per capita*	*-5,4*
Real resource transfer[(a)]	-8,4
Urban Minimum Wages	-3,0

[(a)] The real resource transfer is equal to the difference between domestic investment and domestic savings.
Sources: Preliminary Overview of the Economy of Latin America and the Caribbean, 1989 (NY, UN Economic Commission for Latin America, 1989); Inter-American Development Bank, Economic and Social Progress in Latin America, 1990 Report (Washington, DC, IDB, 1990);
PREALC as cited by Ricardo Infante & Emílio Klein, "The Latin-American labor market, 1950-1990," Cepal Review nº 45, 1992.

Political ideology, pressure from international lending agencies, and the need to shore up the burgeoning budget deficits have all combined to put privatization on the top of the agenda. Starved for investments, Latin America has been undergoing a privatization craze and has been competing for scarce capital with Eastern Europe since 1989, the former USSR since 1990, and the rest of the more developed Third World countries since the late 1980s.[5]

The earliest liberalizers, notably Chile and Mexico, achieved "successful" economic and financial liberalization leading to a market-oriented economic environment. Chile undertook one of the first serious efforts to increase market orientation that took some fifteen years. The costly process was enforced by a strong military dictatorship (Edwards & Teitel, 1986; Solimano, 1992). Mexico's economic reform was achieved under a regime that effectively has been a one-party state (Skidmore, 1992). In both cases, the costs borne by labor and other low-income sectors were exceptionally high. Mexico's financial crisis which erupted in early 1995 demonstrates the vulnerability and fragility of the liberalization process that could prove to be devastating. Economic liberalism with far-reaching changes also has been tried in a number of countries with democratically elected governments, but so far the results have been disappointing.[6]

Unwilling to endure the painful costs of reform and disillusioned with free

[5] At the beginning of the 1990s, global competition for international capital intensified. As demand for fresh risk capital evolved in Eastern Europe and the former USSR it became more difficult for developing countries to maintain or even improve their attractiveness as hosts of investment. Given the ideological component it is quite possible that East European countries would receive 1arger official foreign capital inflows than Latin American countries. Western aid, especially from Western Europe is motivated both by security concerns and ideology.

[6] Reforms were also introduced in Uruguay in 1984; Bolivia since 1985; Argentina since 1990; Peru from 1980-1985 and after 1990; Costa Rica since 1984, Venezuela since 1990.

market policies that had failed to work, voters in a number of countries turned to charismatic politicians who promised populist alternatives. Carlos A. Perez in Venezuela, Carlos Menem in Argentina, and Alberto Fujimori in Peru were elected based on prolabor campaign platforms that they completely rejected as soon as they were inaugurated. Instead of populist policies, they delivered harsh shock treatment adjustment programs. All three countries have now suffered coup attempts; in Peru it was led by Fujimori himself. The political and economic style bears a troubling resemblance to the decision-making process characteristic of authoritarian regimes. Some presidents, for instance, have relied heavily on unilateral executive powers to manage the economic reform process (Torre, 1993).

Attempts at stabilization in Latin America essentially fall into two categories: orthodoxy and heterodoxy. Orthodoxy assumes that to reduce distortions and bring back into balance those elements that have fallen into disequilibrium the objectives are to reduce inflation, eliminate the balance of payments problem, and reduce policy-induced uncertainty. The short-term measures involve fiscal policy aimed at eliminating the budget deficit, monetary policy aimed at restricting monetary growth, simplifying the exchange rate, and dealing with the external debt and foreign financing to restore credibility. Orthodox programs are typically the IMF programs. Heterodoxy uses a combination of incomes policy, fiscal correction, and monetary reform. In contrast to IMF packages that emphasize liberalizing markets, heterodox programs usually involve wage and price controls (Cardoso & Helwege, 1992). Heterodox solutions were normally tried when the harsh effects of neoliberal policies have caused political unrest and economic uncertainty.

Some of the better-known heterodox attempts at stabilization that were aimed at reducing inflation and balance of payments disequilibria included the Austral Plan in Argentina (1985), the Cruzado Plan in Brazil (1986), and the lnti Plan in Peru (1985). The stabilization experience of these three countries has shown that heterodox economic policies do not work because they were never meant to offer anything but a temporary solution (Moskoff & Nazmi, 1992; Paus, 1991).

It is precisely this experience with failure which shock therapists say the post socialist countries should avoid because economic reforms are often blocked by narrow economic and political interests. Some of the advocates of shock treatment, including Sachs (1993) and Dornbusch (1992), have described deviations from the policy recommendations of the IMF as “populist experiments,” implying that policies that deviate from this “new orthodoxy” are unsound (Knell, 1993). The mark of progress in reform for shock therapists lies in the implementation of measures that break the existing economic and political structure. Crucial in this strategy is the quick conversion of the state sector into a decentralized market sector. This should be swiftly followed by rapid privatization. Slowing of this process would be regarded as evidence of the stalling of reforms, or perhaps even their failure.

Three of the illustrative cases for Latin America are as follows. Chile’s orthodox program that used shock treatment in its transition from a tightly controlled economy to outward orientation was not without problems. During the fifteen years of reform, unemployment averaged 17% and during some periods surpassed

30%, while the real wage averaged just above its 1965 level. During the first years, inflation remained at high levels, GDP fell 14% in 1975, and many businesses were forced into bankruptcy. High levels of unemployment and low wage led to a substantial deterioration of the distribution of income (Maloney, 1993; Corbo & Fischer, 1994). After a period of fast growth during the late 1970s, Chile experienced a tremendous setback in the 1982- 1985 period. Only after 1985 was Chile able to move toward growth and recovery. But even when the economy enjoyed growth, the expansion did not bring wages above the 1970 levels.

Mexico's macroeconomic stabilization program, formally agreed to with the IMF in 1982, consisted of two phases: an orthodox shock and a gradualist phase. Lusting (1990) estimates that the impact of the crisis and stabilization process entailed overall economic hardship reflected in lower per capita output and consumption, a sharp decline in real wages, drastic cuts in social expenditures, and large shifts in the functional distribution of income.

Peru's stabilization and program of structural reforms implemented in August 1990, known as the *Fujishock*, reduced hyperinflation to manageable levels, decreased the fiscal deficit, restored the country's credit standing, and corrected relative prices (the exchange rate, interest rates, price of public services). However, Fujimori's economic program also had adverse effects on employment, real incomes, and savings (Gonzalez, 1993).[7]

Despite the modest successes of neoliberal strategies of market-oriented restructuring in achieving external adjustment, taming hyperinflation, and disciplining public sector finance, these neoliberal reforms have not achieved the desired results (Smith, 1993; Ruccio, 1993). While adjustment programs are not premeditatedly anti-poor, there is evidence to substantiate that they are inequitable in that the burden of adjustment has fallen disproportionally on the poor. The evidence from Chile, Mexico, and Peru shows that the incidence of poverty during the time of adjustment increased and inequality and income distribution worsened (ECLA, 1990; Lustig, 1993; Gonzalez, 1993; Paus, 1994). In most countries there has also been an explosive growth of the informal sector, and an unbearable foreign debt that has grown faster than GDP (ECLA, 1992; IBD, 1992).

Resumption of economic growth in some Latin-American countries in the 1990s should not obscure the fact that "the poor now constitute a majority-some 50.5% of the population or 222 million people, an increase of nearly 70 million people in ten years" (Weisskoff, 1993, p. l). The acclaimed "success" of Mexico' s economic reforms ignores half of Mexico's people who are still living below the poverty line. The social cost of adjustment, according to Lustig (1992, p. 61), "pro-

[7] Another orthodox program, and in which J. Sachs was a key economic advisor, was the Nueva Política Económica in Bolivia (1985). White Bolivia succeeded in stopping hyperinflation, breaking the power of trade unions, eliminating wage indexation, and managing to repair its relations with international financial institutions, the program did not transform Bolivia into an economic miracle. Bolivia was praised for its brave policy reforms, but the benefits have been meager. Bolivia remains the poorest country in Latin America and its level of economic activity is practically stagnant.

duced considerable economic hardship for the Mexican people." Liberalization and privatization have not led to greater efficiency, more competition, or a better life for Mexicans (Lustig, 1990). Not only have real wages remained at depressed levels, but many social services have been cut back. In Chile, in 1990 the UN reported that 40% of its population was living below the poverty line (Schneider, 1993). Peru's poor constitute nearly 50% of its population. One can only deduce that in spite of the accomplishments of stabilization and restructuring, as recommended by the IMF, these Latin American countries achieved only modest success in solving their fundamental problems of economic development (Pastor, 1987).

Notwithstanding this record, policymakers were even more eager to preach free markets to Eastern Europe and the rest of the developing world. As Cardoso (1991, p.35) puts it, "The race is on between Eastern Europe and Latin America to reach the promised land of free markets, private enterprise, and prosperity. Countries compete to show who is best in rejecting the past. In the wild swing of the pendulum, yesterday' s truth is today's heresy. Yesterday pervasive public control of the economy was thought to be essential for social progress and decentralization of power, as well as to keep out foreign domination. Today's recipe is just the reverse". But despite a strong electoral mandate, economic shock programs, and the auctioning off of state companies, the grand plans to revamp some of the Latin American economies, with few exceptions, have faltered seriously.

This is not to say that the market has not brought prosperity and worked better in some places than in others. The litany is not meant to belittle the substantial achievements of Chile and Mexico; rather, it tells us that the transition often takes longer than anticipated. Finally, an important factor in the record of achievement of these "successful" economies seems to be the technocratic style and the governments' executive control of economic reforms by less-than-democratic regimes enforcing policies.

THE DILEMMAS OF MARKET-ORIENTED REFORMS IN POLAND

Recent discussions on economic reform in East and Central Europe emphasize sweeping measures to promote rapid transition to a market economy. The current belief places primary emphasis on market forces to solve the problems. Much of the advice offered to East and Central Europe and Russia by the IMF and the World Bank is that gradual reform is unlikely to work and, therefore, change should be carried out swiftly and decisively (Corbo, 1991; Solimano, 1992; Sachs, 1990; Blanchard *et al.,* 1991). Although IMF policy has not been uniformed for all of East and Central Europe (e.g., a more gradualist approach has been applied in Hungary), there are common features that have been put into place to restructure these economies.

Poland implemented the Balcerowicz plan, named after the former finance minister, on 1 January 1990, and measured by the growth of the private sector and the degree of liberalization has moved more quickly than the other East European countries. Economists studying Poland now agree that dismantling the centrally planned economy has proven more difficult than initially expected (BI, 1991; Slay, 1991a).

The Balcerowicz plan (known as shock therapy) emphasized four interrelated aspects: (i) macroeconomic stabilization, (ii) liberalization (end of central planning, deregulation of prices and controls, and integration into the world economy), (iii) institutional restructuring, and (iv) privatization.

Shock therapy may be defined as immediate stabilization, that is, a rapid introduction of a package of monetary and fiscal measures to tighten the expansion of domestic credit, decontrol prices, and eliminate hyperinflationary pressures. The program also included an initial reduction in the budget deficit, the unification of the official and market exchange rates, the increase in the degree of zloty convertibility, wage controls, elimination of subsidies, demonopolization, industrial restructuring, a new role for banking, and an expanded role of foreign investment.

Table 2: Selected economic indicators, Poland, 1989-1993 (annual rates in%)

	1989	1990	1991	1992	1993
Gross domestic product	02	-11,6	-9,0	1,5	3,8
Personal consumption	0,4	-15,3	0,4	5,2	5,3
Consumer price inflation	251,8	585,0	70,3	43,0	37,2
Realwages	9,0	-29,8	0,8	-12,4	-1,8
Industrial production	-2,1	-24,2	-11,9	3,9	6,2
Agricultura! output	1,5	-5,1	-0,9	-11,9	
Unemployment		6,3	11,8	14,0	16,8
Labor productivity		-25,0	-31,0		
Current account balance	2,2	0,6	-0,8	-0,3	-2,3
Gross externai debt (billion $)	38,9	46,6	46,5	47,0	44,0

Source: Glowny Urzad Statystyczny (Central Statistical Office), The World Bank, 1994.

Considered the most ambitious program of austerity and liberalization in Eastern Europe, the design and implementation of the Balcerowicz program benefitted from the financial and technical assistance of western governments and the IMF. However, what surprised most observers was not the fact of economic contraction, but the magnitude of that contraction in 1990-1992.[8] During the first year the GNP declined by 11.6%, real wages by 30%, and employment by 6%. Industrial production also sank 24%. Investment spending declined by 10.1%. Not surprisingly, Poland's economy continued to contract the following year, with GNP falling another 9% in 1991 (see Table 2). GDP in 1992 increased by only 1.5%, just marking an end to the downward trend. After three years of slump, the GDP was more than 20% below the 1989 level. A similar situation was experienced by Chile and other countries where these rigid orthodox policies were initially implemented.

The pronounced decline in economic activity was also reflected in the fall of real wages (26.5% between 1989 and 1992). By early 1992, Slay (1992a) and

[8] At the time that the Solidarity-led government assumed office in 1989 it also had inherited an economy in crisis. The budget deficit was 10% of GDP, money incomes had quadrupled over the course of the year, and inflation was 240%.

Bratkowski (1993) argue that the Polish experiment with liberalism had come to be widely regarded as a failure because in some respects the economic program fell short of its goals. In 1993 the Polish economy showed symptoms of recovery. But a detailed scrutiny reveals that the recovery had a rather weak and fragile basis (Reed, 1993; PlanEcon, 1993). As far as GDP growth and the increasing role of the private sector are concerned, it was a success compared to other post-communist economies.

The weakness of the recovery is that it has been driven largely by increasing domestic demand, particularly consumption. As a result, net savings declined for four years in a row. A sustained recovery requires reversing the downward trend in national savings as a source of investment otherwise this is bound to hurt stabilization policy. Moreover, the resumption of growth has been uneven across regions and social sectors. As a World Bank (1994) report puts it, "social strains have emerged and intensified, driven by the perception of segments of society that the fruits of recovery have not been shared equally". Thus, based on this assessment the World Bank concedes that the consensus for reform is weakening.

The outcome of reform of the Polish economy has a great deal to do with the political environment. The result of the last two parliamentary elections in Poland showed apathy and widespread voter dissatisfaction which increased the pressure on the program of economic reform. The parties most closely associated with the Balcerowiz plan lost heavily. In the parliamentary elections held in September 1993, two parties that are outgrowths of the Polish Communist Party won the elections in a signal of widespread discontent with market reforms. This is consistent with the Latin American pattern, in which several countries (e.g, Brazil, Argentina, Peru) followed a zigzag course in reform as discontented voters churned governments rapidly and policies shifted frequently.

The ideology of laissez-faire, which made its triumphal return to Poland at the beginning of 1990 with support for economic shock therapy, was sidelined by the Olszenski government (first half of 1992) but was back on track under the Suchocka government. Then, in June 1993 Suchocka suffered a no confidence motion called to protest her tight budget policies (Vinton, 1993; Perlez, 1993). At present, the newly elected government formed by a leftist coalition has moved to soften the effects of the economic program. The voters had given their verdict on the economic transformation package by endorsing a less painful approach.

The outlook for foreign trade also is unfavorable as Poland is facing restrictions from the European Union (EU) on its potential agricultural, livestock, textile, and steel exports to that western market. There has been a persistent trade deficit growing, approximately $2 billion in 1994 (EIU: 1994, Polish Foreign Trade: 1994). Trade with the East had also been substantially reduced as a result of the switch to hard currency trade, the collapse of the Soviet market and shock associated with the breakup of the Council of Mutual Economic Assistance (CMEA).[9] With its

[9] As a result of a persistent trade deficit with the West as well as strict quotas and tariffs on Polish exports by the EU, in June 1994 the Polish government said it was reversing its policy and sought closer

external accounts deteriorating, pressure has required three devaluations of the zloty (along with the use of the crawling peg), that have had a tendency to aggravate the inflationary pressures in the economy.

Comparison of actual economic performance to optimistic government projections provides revealing evidence that the results achieved diverged considerably from those expected (Slay, 1992a, 1994; Bratkowski, 1993; Poznanski, 1993). Official projections forecast economic recovery by mid-1990, but these errors raised false hopes.[10] Given the extended adjustment period that occurred even in Latin American countries regarded as "successes," it is difficult to understand why such optimistic predictions were made. Although shortages and lines, endemic in Communist Poland, have disappeared, inflation was still hovering at 37% at the end of 1993 and 32% in 1994. Real incomes continued to fall by 9% in 1992 and 3.2% in 1993. With the introduction of 22% value-added tax on goods and services in 1993 and the devaluation of 8% of the zloty, that added to the squeeze on incomes and a rise in consumer prices.

Although the severe recession of the first three years did bottom out and the economy experienced a healthy 4% growth in 1993 and 4.5 in 1994, there are still four major problems that stand in the way of a sustained economic recovery in Poland. These are the labor conflicts over wages and security benefits, inflation and unemployment that remain stubbornly high, fiscal problems of state enterprises and the banking system, and the gloomy outlook of agriculture (Slay, 1992b; 1994).

When Poland's Solidarity government took power from the communists in 1989, it enjoyed an approval rating of 90%. Today there is popular disenchantment stirred by an economy facing rising unemployment and threats of further layoffs if mass privatization goes forward. The labor union which helped to bring about the fall of the communist government finds itself opposing the forces which it helped to unleash, and paradoxically, has been the main laser in the transition (Rapacki, 1993). Unable to play the dual role of union and governing party, Solidarity's strongest factions have parted with Lech Walesa and moved decisively to the left of the political spectrum, criticizing the economic situation and calling for effective long-term remedies (Jasiewicz, 1992; Zubek, 1993; EIU, 1993; Sabbat-Swidlicka, 1993). Walesa, who is now Poland's president, is himself one of the country's most unpopular politicians.

Since the Communist Party surrendered power in 1989, Poland has had seven prime ministers, four governments and four national elections. Public opinion surveys indicate that much of the frustration and anger among workers stems from the high unemployment rate (approximately 17%, about 3 million people) in a land

relations with Russia and the CIS with which it has had a trade surplus, stating that this motivation was purely economic. See "Poland, in a shift, will seek closer ties with the Russians," The New York Times, 9 June 1994

[10] The 12% decline of GDP in 1990 exceeded the official expectation of 3%, industrial value added fell by about 23%, while production of socialized industry fell by almost 30%. Cumulative inflation in 1990 was 250%, compared with an expected 90% (Calvo & Coricelli 1992).

where jobs formerly were a constitutional right (Kowalik, 1991; Henzler, 1991; EIU, 1994). The drastic increase in the number of strikes in 1992 and 1993 nearly brought the stabilization program to a halt (Goldstein & Loveless, 1992; Zaremka, 1993). Public backlash as adjustment proved too painful occurred with the return to power of parties that were descended from the communist system. Some of the factors explaining this are the widening income disparities, the loss of economic security, a weakening in the purchasing power of consumers due to the high rates of inflation, and the rejection in the countryside (where about 40% of the electorate lives) of the government's policy of open trade and the high cost of credit.

The rapid economic reorientation may have contributed to prolonging the political uncertainty and undermining the successful aspect of the transformation. In this transition process there is no doubt that sometimes failures resulted less from faulty policy than from political obstacles. In this sense, some of the political and economic features of Poland resemble those of some Latin American cases, such as Brazil, Argentina, and Venezuela, where harsh measures undermined support to the high price of reform turned people against populist governments.

The angst of most Poles is linked to uncertainty, unemployment, and declining real incomes.[11] People now have ambiguous attitudes toward the market as they see high rates of unemployment, increased social stratification, labor instability, and rampant corruption (Ost, 1991; Ash, 1992; Blejer & Gelb, 1992). Until 1994 the inflation rate in Poland was not only the highest in Central Europe but was much higher than the average in the EU. Unemployment rates at the end of 1993 were the second highest in East and Central Europe.

As debtor, Poland ranks right behind the biggest Latin American debtors. At the end of 1992, Polish hard-currency debt amounted to $47 billion. However, despite the preferential treatment Poland has received on debt relief from the Paris Club governments to reduce it by 40%, the country still owes over $40 billion. Similarly, an agreement was struck with the London Club in mid-1994 to reduce half of Poland' commercial bank debt. Banks and diplomats insist, however, that it would take time before the positive effects are felt on the Polish economy.

On the investment front, Poland so far has attracted comparatively little foreign direct investment. In fact, it has lagged behind Hungary and the Czech Republic. Early estimates of direct foreign investment were overly optimistic and overlooked the fact that the initial interest was simply a way of testing the water. Although the West strongly supported the transformation process, the volume of aid and investment has been less than anticipated. According to one report, "only $1.1 billion in long-term capital flowed into Poland between 1990 and March 1994, plus a mere $250 million of net portfolio investment" (Robinson, 1995). Another report notes that as of December 1993 foreign firms had committed $2.8 billion,

[11] A World Bank report notes that "in the past three years poverty has increased across the board in Poland as a result of the recession and rising unemployment." It is estimated that now 5-6 million Poles are poor. That is about one seventh of the population.

up from $1 billion at the end of 1991 (EIU 1993a, b; Reed, 1994). But the increase is the result of the conclusion of a few large deals with firms like Fiat ($1.8 billion investment). Thus, these investment figures distort the picture because these are pledged investments that have not yet fully materialized but might find their way into Poland in the next few years. Whatever the outcome, a heavy reliance on foreign capital to solve some of Poland's immediate problems appears unrealistic.

Although by the middle of 1992 the number of state-owned enterprises privatized or liquidated in Poland reached 1,249, the privatization program has run into trouble due to legalistic quibbling and financial disagreement (Krawczyk & Lopez-Lopez, 1993). In March 1993, the Sejm voted against approving the Polish mass privatization program and the process was stalled. Rapid progress was made in selling or renting trade and service establishments during the l990-1991 period under the small privatization program. Individual or "liquidation" privatization has also gone forward successfully. However, efforts to sell off hundreds of large state-owned enterprises have been hampered by government wavering and trade union pressure.

Although nearly 2500 state enterprises were to have been privatized by the end of 1992, only 668 had actually completed the privatization process (Slay, 1994). The legislation of July 1990 had failed to impose a well-defined structure of the process. Trade unionists and workers' councils within firms also strongly opposed the privatization of their firms. The harshest criticisms of the private sector were focused on corruption and the loss of revenue from tax evasion.

By the end of 1993, the private sector was producing approximately 50% of Poland's GDP. Also, over 50% of the Polish work force is currently employed in the private sector, mostly in services and retail (Reed, 1994). Private sector employment in retail trade amounted to 91% the first quarter of 1993 (Vinton, 1993). However, the proportions for industry are lower. The private sector amounts to only 32% of industrial output and 43% of employment in industry. These figures show an unjustifiable optimism since the vast majority of jobs in small firms of the private sector are low paid, low skilled, and marginal (Hardy & Rainnie, 1994). Moreover, the growth of the small and medium-size private sector in Poland did not start in 1990 but in the early 1980s.[12] Slay (1993) also points out that private firms have provided only a small fraction of budgetary revenue through taxes and tariff duties despite the fact that the private sector accounted for almost half of all imports. This evidence strongly calls into question the virtues of the market as privatization policies have not contributed sufficiently to revenues for development. Again, the patterns in Latin America are repeating themselves. Countries such as Mexico and Peru have not seen government revenues increase sufficiently with large

[12] Hardy & Rainnie (1994) document that "at the beginning of the 1980s there were approximately 5,000 private manufacturing firms nationally, employing 12,500. Ten years later the number had risen to around 40,000. The number of firms in the nonagricultural private sector increased from 351,000 in 1981 to 572,000 in 1988. Employment in these firms rose from 654,000 to 1.287,000 (i.e., almost doubled) in the same period" (p. 49).

scale privatization. Instead, as Thobani (1995, p.12) puts it, "the bulk of the proceeds from privatization have been earmarked for funding public debt in most countries".

The objectives associated with privatization include reducing the government's deficit, generating new sources of cash flow and financing for enterprises, and long-term increased productive efficiency. However, privatization raises the same issues in both Latin America and Eastern Europe. Although the technical aspects of privatization are discussed, it is often forgotten that it is an intensely political issue (Liberman, 1994). It starts from an ideology that private ownership works better than government ownership. It also involves a massive redistribution of wealth that generates disparities and causes workers to fear losing not only their jobs but also other social services.

Privatization, tax reform, and trade liberalization offer the possibility of reducing fiscal imbalances. Yet the benefits of reducing fiscal imbalances are not so clearly defined. In the long run privatization by itself does not resolve the underlying imbalance between public revenues and expenditures. Tax reform and redefinition of spending priorities are required. Privatization also might merely transfer monopolistic entities from public to private control unless such entities are broken up. Privatization is justified by some on the grounds that private ownership is more efficient in terms of resource allocation than public ownership. But others argue that privatization is unlikely to generate major gains in efficiency, particularly if the entity remains a monopoly because the central problem is not public ownership per se but mismanagement (Liberman, 1994).

The downside of privatization not only in Poland but in a number of Latin American countries include: underpricing the firms to be sold, concentration of ownership, improprieties in transferring ownership, insensitive treatment of dismissed workers, price gouging by the newly privatized firms in the absence of local competition, and little or no social services (Frydman & Rapaczynski, 1993; Rosenberg, 1993; Shirley, 1994; Winiecki, 1991). The study by Bazdresch & Elizondo (1992, p.15) of the Mexican experience confirm that "it is not evident that privatization has generated more competitive markets". In the case of Chile, Meller (1992, p. 9) notes that "divestment of public firms has been so rapid that there has not been time to establish a regulatory framework within which natural monopolies will operate". Another controversial issue surrounding Chilean privatization was the value of the sales themselves which sold at less than their "true worth",

THE RELEVANCE OF THE LATIN AMERICAN EXPERIENCE

Few economists would be willing to deny the need for economic reform both in Latin America and Eastern Europe. There is also no doubt that market forces have an important role to play in world development. But the belief that the simple elimination of central planning and the introduction of private ownership will automatically generate a market system offers no guarantee of sustainable economic development in the area. As Galbraith (1991), Ellman (1994) and Ost (1992) point out, the problem is not capitalism but the attempt to impose it according to ready-made blueprints without taking into account the country's real situation. As the examples of Poland and Latin America show, shock therapy exacts a high price and without an authoritarian government in place to force people to swallow painful adjustments, is less likely to yield the desired results. There are other paths to economic reform, however.

The spectacular success of the Asian NICs was based on the increasing strengths of their economies on market forces, but they have used a system of controls and regulations or "governing the market" to create the conditions that have made them more competitive. The historical experiences of these countries contradict the belief that a successful capitalist economy will be spontaneous appear once private property is established, prices are set, currency is established, and unregulated competitive markets are introduced. This does not recognize that markets must be made, that they don't emerge by spontaneous entrepreneurial action. They have to be established by state action (Dell, 1991; Kregel *et al.,* 1992; Amsden *et al.,* 1994).

Another frequent mistake is to assume that if governments refrain from interfering with market forces, they will bring into play all the benefits of competition. This is not the case, especially in developing countries, where the size of the markets is often too small to support more than one or two manufacturing firms in particular sectors operating at the optimum scale of production. Moreover, market forces do not necessarily generate competition-they may, in fact, facilitate the creation of monopolies or oligopolies by the strongest firm or firms, as has been the case of Chile and Mexico.

The perception of the market that has emerged is rather simplistic, as the characterization of the system has suddenly changed from totally negative to totally positive (Darton, 1993b). But in Poland, for some sectors of the population the fascination with the market is fading as a result of a decline in living standards. While some problems related to shock treatment seem unavoidable, it is the severity and duration of economic results that exacerbate the difficulties.

Edwards (1992) maintains that experiences in Latin America (particularly Chile and Mexico) during the last 15 years offer important lessons of largely successful stabilization and liberalization programs that provide useful information for understanding the options in the former socialist countries of Central and Eastern Europe. The Chilean case shows that in 1973 this country faced initial conditions as close as they could possibly be to those faced by Eastern European countries such as Poland in 1989: declining aggregate output, repressed inflation, monetary overhang, generalized black markets, large fiscal deficit, and an inefficient state sector. The Chilean case is illustrative for its lessons on stabilization: the elimination of price controls and subsidies, deindexation and the control of the labor markets, using the exchange rate as an anchor to bring down inflation, and privatization. All this has also been tried in Poland.

One important difference between the Chilean and Polish programs is that Chile was under a strong and repressive military government that was able to carry out these policies by banning trade unions and jailing its opponents. Other Latin American countries that had embarked on liberalization policies had fallen short of their initial objective. By 1985, when it had become apparent that orthodox policies of the preceding decade had failed to contain inflation, newly elected governments turned to heterodox prescriptions (Austral Plan 1985, Cruzado Plan 1986). For some countries like Argentina and Brazil, the year 1990 witnessed an end to experimentation with heterodox stabilization approaches and a move back toward more orthodox policies. Heterodox policies were, at best, successful only in the short run because they failed to remedy the underlying causes of instability.

The neoliberal economic policies which several Latin American countries have been implementing have been seen by the IMF as desirable, even though the results to date have been dismal (Petras & Vieux, 1992; Lowenthal, 1994). Sunkel (1992) stresses that the neoliberal policy menu has been pushed with little variation everywhere, regardless of the country's "initial condition" and is presented as constituting the ultimate wisdom, a generalized consensus. One aspect not yet fully understood by the East Europeans and the former Soviet republics is that economic freedom does not automatically guarantee the welfare of the people. Przeworski (1993) notes that many countries are urged to short-circuit the democratic process, and in this sense the Latin American experience leads to pessimistic conclusions.

To date, economic advice to Eastern Europe has ignored institutional economics. Western advisors advocate free labor markets to raise productivity but fail to consider that workers may be motivated by a system of permanent employment; they advocate entry for foreign investment but forget that those countries lack the structure to screen foreign investment. The belief that uncontrolled free markets should be left to allocate resources and large corporations left to control investment decisions could actually result in the undermining of democracy.

The doctrinal change sweeping over the Third World has only a short list of successes: South Korea, Taiwan, Hong Kong, and Singapore. And as was true elsewhere, success has come to countries with authoritarian or interventionist governments. In Korea and Taiwan the government had to intervene to create a competitive edge by providing subsidies, trade barriers to protect the domestic market, and low cost credit (Amsden, 1992,1994; Wade, 1990). In sharp contrast to Eastern Europe, more than a decade earlier China had begun a program of gradual economic reforms resulting in a remarkable spurt of economic growth that continues up to the present time. The Chinese gradualist strategy that conformed least to the big-bang approach has certainly been more successful (Griffin & Rahman Khan, 1994).[13] Since Latin America embarked on this liberal economic process, Chile and

[13] China's successes raise many challenges to the shock therapy approach because its reforms were

Mexico have more seriously and consistently pursued market reform and produced the best economic performance at a high social cost. But these two countries have yet to deal with the consequent social disparities and distortions.[14] The few notable exceptions in the Third World are only one face of modern capitalism; the other countries have been left out and are falling even further into poverty and underdevelopment.

Although economic reform is both desirable and feasible, its design and obstacles to successful implementation are complex. A question that is often asked is whether the transition from central planning to market must inevitably be associated with a deep recession. Although some recession is probable, it could also result in more pain than gain. Some of the lessons from those Latin-American countries that have tried to stabilize and reorient their economies are that: (i) market-oriented reforms do not necessarily lead to a better quality of life for a large sector of the population as reforms have failed to address equity; (ii) the process of market reforms is inevitably painful and takes longer than initially estimated; (iii) stabilization and liberalization are necessary but not sufficient to assure prosperity, long-term growth, and structural competitiveness; (iv) political support for reforms erodes unless reforms are accompanied by a social policy; and (v) autocratic political style in implementing reforms can weaken the emerging democratic process.

The transition from state-socialism to a market-based economy is not a quick-fix proposition. Very rapid economic reorientation can prolong the political uncertainty and undermine the success of the transformation. The challenge of the transition also will be in realizing that capitalism is not only Sweden and the United States but also the Third World (Komlosy & Hofbaver, 1994). The new democratic experiment in Poland seems fragile but its durability will depend to a large extent on the economic performance of the reforms undertaken and evidence that they provide a credible mass prosperity. Although the reform program enjoyed initial support among the people, this support has eroded because the high cost of reforms makes it politically unappealing and could ultimately tum out to be unsustainable. The implication seems to be that it is quite difficult to pursue rapid economic reform and true democracy. If Poland is truly such a success, why did Poles in free and fair elections voted for representatives of the *ancien regime?* The key question remaining is whether the western notion of democracy in Poland today would impede or enhance the economic transformation process.

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partial and incremental, did not cause an initial severe depression, made no use of large-scale ~~privatization, and~~ avoided declining incomes and high unemployment.

[14] According to government and United Nations figures, 40% of Chile's 13 million people, or 5.2 million were living in poverty in March 1990 when Mr. Aylwin took office after 17 years of military government. Chile has since 1990 launched an antipoverty campaign "using an aggressive policy of tax increases, heavy social spending, and vigorous free market economic growth that goes beyond the trickle-down effect", Nathaniel Nash. The New York Times, April 4, 1993, A6.

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