ECONOMIC PAPERS

COMMISSION OF THE EUROPEAN COMMUNITIES
DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS

Number 92 May 1992

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II/217/92–EN This paper exists in English only

LESSONS FROM THE STABILISATION PROGRAMMES OF CENTRAL AND EASTERN EUROPEAN COUNTRIES, 1989-91.

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1. Introduction.

For a number of years before 1989 central eastern European countries had been facing, to various extents, severe domestic and external imbalances, economic slowdown or decline and the need to restructure production capacity, while attempting to reform their traditional central planning system (see Nuti, 1988). These problems were less intensely felt in Hungary and Yugoslavia, both early starters on the road to reform, relatively free from endemic shortages and more open to trade with the West; but even there the same underlying trends were present. In the first half of 1989 Gorbachev's perestroika and Soviet economic debacle led to Soviet acquiescence to the demise of the communist party in Poland; this in turn triggered off a cascade of political revolutions in the other central eastern European countries in the second half of the year.

The 1989 revolutions had three immediate economic effects:

- the target model of economic reform switched from the search of a market-oriented version of socialism back to the restoration of a capitalist economy, with dominant private ownership and enterprise;

- the new governments, unlike their communist predecessors, enjoyed the kind of political legitimacy and popular support necessary to undertake unpopular measures of stabilisation;

- the end of Soviet rule over the bloc led to the speedy collapse of CMEA trade arrangements (with formal CMEA dissolution in September 1991), which imposed greater opening of central and eastern European economies and the reorientation of their trade towards the West.

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1. An earlier version of this paper was presented at a Conference on Impediments to the transition: the Eastern European countries and the policies of the European Community", EUI-EPU, Florence, 24-25 January 1992. Acknowledgements are due to Conference participants and to Grzegorz Kolodko for useful comments. The views expressed in this paper do not necessarily reflect those of the Commission of European Communities.

The new political conditions and the precarious state of these economies required urgent stabilisation plans, to put an end to shortages, open inflationary pressures and impending debt crisis; radical institutional reform, including for the first time large scale privatisation; opening to international trade and finance; these were also preconditions for effective restructuring of productive capacity. Former political obstacles to these measures were no longer present. Thus a wave of stabilisation and reform programmes supported by loans and grants from international organisations and western countries, were introduced in rapid succession in 1989-91. The exceptions were Hungary, which could continue with a gradualist approach because of a much earlier start; the ex-GDR, which rapidly achieved the same targets by virtue of German reunification; the Soviet Union, because of disastrous procrastination.

When, in the autumn of 1989, the first non-communist government in Poland started preparing its plan there was no precedent for the simultaneous undertaking of stabilisation, systemic transition and capacity restructuring, and on such a large scale. Therefore it was natural to proceed from first principles and to look - because of underlying hyperinflation - at the experience of Latin American stabilisation plans in spite of their extremely poor record. Today, however, when exploring desirable economic strategies for the further progress of transition in the whole area, there is no justification for ignoring the performance of stabilisation plans to date, the experience of transitional economies which for any reason have not undertaken such plans (Hungary, ex-GDR, the Soviet Union before its disintegration at the end of 1991), as well as that of economies further East, such as those of Vietnam, China and the more successful South East Asian countries. This paper is an attempt at drawing some lessons from the experience of central eastern European countries in 1989-91 (on Vietnam see Kolodko 1990a, Kolodko et al. 1992; on China, Chen-Jefferson-Singh 1990; on South-East Asian economies, Fry-Nuti 1992).

2. Gradualism versus speedy transition: Hungary and the ex-GDR.

Hungary and the ex-GDR represent unique, extreme, opposite patterns respectively of gradual and instantaneous "transition", which could not be followed by other countries.

Hungary, by virtue of its early start with the 1968 New Economic Mechanism (NEM) and better economic conditions, was able to avoid a drastic programme in 1989-91 and continued its gradualist strategy, now redirected towards the new target model. Its earlier achievements provided a model for the other countries in a number of areas: the transformation of the monolithic monetary and banking system into a multi-level, competitive and pluralist system; the liberalisation of trade and foreign investment; the development of an articulated tax system, replacing diversified (ad hoc and often enterprise-specific) tax and subsidy rates with uniform rates of income and value-added taxes; the development of financial markets first for bonds then for shares. The option of gradual transformation, however, by 1989-91 was no longer open to the other countries: their domestic and (except for Romania) external imbalances had cumulated to unsustainable levels, CMEA had disintegrated cutting them off cheap Soviet supplies of oil and materials, and less favourable conditions prevailed in international trade and financial markets, with respect to Hungary's position in the first years of NEM.

The ex-GDR achieved all the desired goals (stabilisation, systemic transition, opening of the economy) at once, by virtue of accelerated reunification with Federal Germany, first de facto then de jure in under a year (see Siebert, 1990a and b; Jackson, 1991a and b). The Ostmark overhang was partly confiscated partly made good by instant replacement with a convertible currency; a complete new price system, body of legislation, set of financial institutions were imported at a stroke; the economy was not only opened but also joined to the European Community; all these factors facilitated privatisation.

The ex-GDR transition incurred additional costs, with respect to other countries, because of the rapid growth in real wages, which caused large-scale unemployment. This was due not to the one-to-one DM/Ostmark rate of conversion for wages, as it is often believed, as this only had a once and for all wealth effect actually sustaining demand and employment; unemployment was due to labour mobility, started first with migrations through Hungary then through the gaps in the Wall, and totally free after unification. These additional costs, as well as the general costs of such a speedy transition and restructuring, were born mostly by the Federal budget and German financial markets, rather than only by the ex-GDR population. While some aspects of the German experience are potentially repeatable in other countries (for instance, rapid privatisation through Treuhandanstalt), neither the ex-GDR transition model nor the speed of its implementation are repeatable anywhere else.

3. Stabilisation and reform plans, 1989-91.

The first stabilisation plan of 1989-90 was introduced by Yugoslavia (1-12-1989; see Coricelli-Rocha, 1990). This was, however, a fairly conventional plan (see table 1), which could not provide a model for the other countries. Yugoslavia had virtually no overhang, already had a considerable degree of economic decentralisation, fairly free trade and a nearly convertible currency, experience with restructuring and a pool of labour unemployment. Moreover the Yugoslav programme was rapidly aborted in mid-1990, because of republican failure to comply with federal wage guidelines and resulting monetary indiscipline and pressure on the exchange rate; convertibility was suspended de facto in late 1990; the country precipitated into civil war in 1991.

The first comprehensive and innovative programme for stabilisation and reform was the Polish plan of 1-1-1990, associated with the name of Finance Minister Leszek Balcerowicz. It included broad price and trade liberalisation, nominal anchoring of the programme to money wages and the nominal exchange rate, targeting the real money supply and real interest rates, monetary and fiscal austerity, large devaluations and internal convertibility, extreme fiscal pressure on the state sector, taxes on excess wage increases and, in the longer run, privatisation and capacity restructuring. The Polish stabilisation plan has provided a prototype for other transitional countries: in 1990-91 similar plans were introduced in Romania (1-9-1990), Czechoslovakia (now known as CSFR, or Czech and Slovak Federal Republic, 1-1-1991), Bulgaria (1-2-1991).

Meanwhile, in 1989-91 the Soviet Union continued its inexorable march towards repressed and open hyperinflation, economic disorganisation and supply disruption, republican disintegration and associated drastic falls in consumption and output. The end of the Soviet Union, accomplished by the August 1991 putsch failure, was formalised by the creation of a smaller and looser Commonwealth of 11 Independent States (CIS; SNG from the Russian initials), established by the Alma Ata and Minsk treaties of December 1991 and excluding Estonia, Latvia, Lithuania and Georgia. This paved the way for the unilateral introduction by Russia of a stabilization and reform programme on 2 January 1992. The programme had been announced by Boris Yeltsin on 28 October 1991 but would have been incompatible with the Draft Economic Union Treaty, then still under discussion, which excluded unilateral price increases by individual republics. Implementation was originally due in mid-December but was postponed at the request of other republics, notably Ukraine; a second, much more coherent round of measures is to follow in April 1992. Russian price liberalisation has had forced all the other ex-Soviet republics to follow, because of the continued use of roubles as legal tender not only within CIS but also in the rest of the former Union; however the other republics, including Ukraine, are very much behind on their way to a new system. The Russian package has a great deal in common with the Polish prototype of January 1990, on which it is modelled. However, in view of the speed of developments, the special features of the ex-Soviet area (such as size, the persistence of a rouble area and the planned introduction of republican currencies, inter-republican trade and payments regime) and of the Russian programme, we shall leave it out of this paper (see Nuti and Pisani-Ferry, 1992).

4. The Polish prototype.

The Balcerowicz plan envisaged the following steps (see Kolodko 1990a and 1990b, Nuti 1990a, Rosati 1991a and 1991b):

i) instantaneous price liberalisation of 90 per cent of transactions and a reduction of government subsidies (from 17 per cent of national income in 1989 to 4 per cent in 1991); initially some budgetary support was retained for coal, electricity, gas, state housing rents, heating and hot water, transport and telecommunications, pharmaceuticals; support was reduced for energy in June 1990.

ii) a balanced state budget for 1990, accompanied by a restrictive monetary policy aimed at restoring a positive real interest rate; interest rates were raised on old as well as new credit contracts. State enterprises assets were revalued on average by a factor of 14 (and again in 1991), at rates differing by type of assets but uniform throughout the economy, with a uniform capital tax (called a "dividend", improperly because it bore no relation to either current profits nor reinvestment requirements of enterprises) levied on revalued state assets. Average turnover tax was raised from 10 to 20 per cent.

iii) wages policy; money wages were set for January on the basis of an expected monthly rate of inflation of 45 per cent in January, with maximum wage guidelines indexed to prices at a monthly prefixed rate for 1990: 20 per cent of price inflation in January, 30 per cent in February to April, 60 per cent in the rest of the year except for June (when energy prices would be raised) when wage indexation was at 100 per cent. A tax on wage increases over these guidelines (PPWW or "popiwek") was levied, at progressive rates of between 200 to 500 per cent of excess wages, exclusively on enterprises with state majority capital.

iv) unilateral suspension of debt service from 1-1-90, soon followed by formal rescheduling of foreign debt, with interest and debt amortisation due in 1990 postponed to 1991; large scale debt relief was granted by official creditors in April 1991.

v) zloty convertibility for residents and for current account transactions; following the devaluations of 22 and 28 December on 1-1-1990 a further devaluation of the zloty by 31.6 per cent (43 per cent in ten days) lifted the US dollar to 9,500 zlotys, i.e. practically to the end-year free market rate (the black market for foreign exchange had been legalised already since March 1989). Domestic enterprises could buy freely at this rate to finance current imports; households could buy dollars for current purposes (i.e. not to invest in foreign assets) from licensed foreign exchange "counters", at a floating rate which was maintained very close to the official rate. A US$ 1 bn loan was made available by the G-24 to support convertibility, in addition to US$ 700 mn IMF standby, US$ 300 mn structural adjustment loan from the World Bank (plus additional project loans totalling US$ 780 mn in 1990) and a substantial package of aid and loans from the EIB, the European Community, its member states and other members of the G-24; there was an informal commitment to maintain the rate of exchange constant until May 1990, but this was not taken as a performance criterion. In the event the rate of exchange was maintained until mid-May 1991, when the zloty was devalued by 17.4 per cent and linked to a basket of currencies instead of the dollar; in October 1991 a crawling peg regime was introduced, with a maximum monthly devaluation of 1.8 per cent.

vi) trade liberalisation, with a new tariff system whose average incidence was 12 per cent, followed for most goods by a tariff reduction to 5 per cent (April) or outright suspension (July); the elimination of export quotas (in January and in October 1990) except for coal and a small number of items (though 20 commodities were still subject to licences at the end of 1991), and automatic authorisation to trade for all registered firms whether state or private.

vii) an undertaking to implement further institutional reform in the direction of a private market economy, including the development of banking and credit institutions, competition, privatisation and the introduction of financial markets, accompanied by capacity restructuring in the medium term. A spate of new legislation was introduced in 1990-91 to implement this part of the programme. Following extensive debates on privatisation a new Law was adopted in June 1991 (see Nuti, 1990b); small scale privatisation (housing, retail and catering establishments, land) was to be followed by large scale privatisation of state enterprises; however this side of the programme was delayed mostly because of the technical difficulties of implementing mass privatisation (see Grosfeld-Hare, 1991). This was to take place through the free distribution to the whole adult population of entitlements to certificates in foreign-managed investment funds, but their establishment was postponed to late-1992; there were also delays due to the complexities of property restitution to old owners (so-called "re-privatisation", first introduced by Germany and followed throughout the area except Yugoslavia).

5. Other Polish-style plans, 1990-91.

Table 1 summarises the main features of the Polish plan and the main differences with respect to the plans subsequently adopted by other countries.

Romania adopted a more gradual price liberalisation in three stages, beginning on 15 November 1990, 1 April and 1 July 1991; prices increases were subject to three months advance notice to be given to central authorities. The nominal anchor was fixed as a 15% increase of the nominal money supply. A special fund financed out of a 10 per cent tax on enterprise profits was set up for the purpose of liquidating interenterprise arrears (400 bn Leu). There were no provisions for wages policy. Convertibility was supposed to be introduced on 27 September 1991 but was postponed in the absence of a government and implemented on 11 November under a "managed float" regime (See Romania Economic Newsletter, vol. 1, n. 1, 2, 3, 1991).

The CSFR took in 1990, ahead of the stabilisation plan, preparatory measures that in Poland had followed the plan, such as major legislative changes, price increases, tax changes (see Hrncir-Klacek, 1991). With the 1991 plan convertibility was granted to enterprises, excluding households; even for enterprises access to foreign currency was subject in practice to considerable delays. Small scale privatisation proceeded fast but large scale privatisation, much more reliant on free distribution of assets to the population, has been greatly delayed. Inter-republican conflicts between the Czech and the Slovak Republics have characterised the CSFR experience, with the creation of duplicate Ministries and Agencies at the federal and the republican level, and the difficulties of coordinating fiscal policy, privatisation, and other aspects of stabilisation and reform. Inter-republican conflict, though not as sharp as in the Soviet Union/CIS, the Russian Federation or Yugoslavia, has been a brake on transition progress.

The Bulgarian plan was perhaps the one closest to the Polish prototype, however with more gradual trade liberalisation, nominal anchoring to the money supply, slower privatisation of state assets (even small scale, except for land, where quick progress was made). The lower real wage reached after price liberalisation was stabilised and strongly indexed, unlike the Polish real wage guideline which was indexed much more weakly but was referred to the pre-stabilisation level. (Angelov, 1992).

6. Economic performance.

The main indicators of macroeconomic performance in the five central eastern European countries under consideration, immediately before and after the stabilisation plans, are summarised in Table 2. Yugoslavia is atypical, because of both plan abortion and civil war.

The programmes succeeded in establishing market clearing prices, except of course for Romania during the intermediate stages of price liberalisation. Inflation predictably rose at first (Romania and Bulgaria are still at that stage) but was brought down fairly fast in Poland and even faster in the CSFR (with price stability in the summer 1991) although it is still subject to sudden revamping. Fiscal deficits in 1991 (not shown in the table) have been higher than expected because of a lower tax basis for the state sector, lower tax rates and lower collection rate for the private sector, higher welfare expenditures made necessary by higher unemployment and poverty.

With the exception of Yugoslavia, the degrees of convertibility introduced with the stabilisation plans were maintained. Exports in convertible currencies rose, mostly because of diversion to trade to Western countries; imports were cut often drastically.

Everywhere the recession of 1989 accelerated in 1990 and continued in 1991 and 1992. The collapse of CMEA trade exacerbated recession; this is generally regarded as an exogenous shock but was actually the result of a deliberate, concerted action on the part of Soviet trade partners, seeking economic independence in spite of the cost, and refusing to maintain CMEA even in a modified form, or to establish multilateral clearing arrangements among former members. Soviet economic decline was another contributory factor. Thus persistent recession was at least partly unrelated to the presence or the intensity of the stabilisation effort.

There are ongoing debates on whether the depth of recession has been perhaps overestimated, due to the underrecording of the growth of private activities, including a "black" or "grey" sector. However, given the initial low weight of the private sector, no plausible allowance for such a possible overestimate is bound to make a difference to trends.

Unemployment, virtually unknown before the start of the plans (except for Yugoslavia), rose fast, not anywhere nearly as fast as output reduction but faster relatively to output than in western countries at times of recession.

Prospects for 1992 are dim everywhere in the area: further output decline or stagnation, and further unemployment, is expected. According to OECD the average GNP decline in the area was about 10 per cent in 1991 and is expected to continue at 2 per cent in 1992.

A number of political and economic lessons can be drawn from these experiences to date.

7. Political lessons.

Economic austerity requires political legitimacy, and a formal or informal social pact. Under a communist government in Poland a modest real wage cut of 8 per cent in early 1988 was followed by successful street protest and overcompensatory wage claims, ending up with the resignation of the Minister who had taken the initiative, Zdzislaw Sadowski, and an increase in the (statistical) real wage of 17 per cent; Balcerowicz got away with a real wage cut of one third. In Bulgaria the stabilisation plan could only be introduced under a coalition government and a non-communist President, with a social pact with the Trade Unions, succeeding where the former government had failed. Hungarian stabilisation, though slower, also relies on social accord through its Council for the Reconciliation of Conflicts, though its implementation leaves something to be desired. Romania, where the government lacks the necessary popular support, is lagging behind. The best contribution that a communist government can make to stabilisation is to follow Mieczyslaw Rakowski's example and to take unpopular decisions before resigning.

Political legitimacy needs a local (regional, republican) foundation. The 1989 revolutions were not only anti-communist but also anti-centralist. Centralisation of economic policy decisions, even in conditions of political pluralism and free elections, is no longer acceptable. This is demonstrated not only by Yugoslav, Soviet, Russian and Czech/Slovak separatist moves but also by the autonomy acquired de facto by large cities and small regions especially in the ex-Soviet Union.

Economic crisis is necessary - up to a point - to impose consensus on drastic measures. Protracted and endemic shortages, inflation and hyperinflation are a great problem but also mollify the population and reduce popular resistance to the shock therapy of an austere stabilisation plan; thus governments should not be so reluctant to free prices even before a proper stabilisation plan. This is also confirmed by the Yugoslav experience; in the ex-USSR outside Russia, and perhaps in Romania, things may have to get worse before a Polish-style stabilisation plan can be fully implemented.

Popular support for austerity, even when undertaken by a legitimate government, is short lived. Unpopular measures should not be spread over time but taken as quickly as possible. The population should soon be able to perceive some living standard improvement after the fall; if a positive supply response is too slow or too weak to allow an early reversal in consumption trends then one should deliberately induce a worse squeeze than strictly necessary so as to then be able to deliver the expected and pre-announced improvement within the honeymoon period, after which the population will stop being cooperative. In Poland this period lasted roughly 200 days and in other countries the honeymoon is unlikely to last longer. The improvement has to be sustainable; "double-dips" in consumption have adverse effects on expectations.

There is a great danger of populism in the course of stabilisation. Populist temptations should not be tolerated; on the contrary they should be discussed, identified, publicised and specifically rejected. For a start, the costs and risks of speeding up transition and especially trade liberalisation and convertibility should be recognised by the government. In particular, unemployment should not be underestimated and appropriate provisions should be made for it: belittling the costs of stabilisation, as it was done in Poland, is as populist a practice as the making of impossible promises.

8. Domestic macroeconomic balance.

Shock therapy stabilisation can bring an instant end of shortages, through a large but tolerable hike in prices, after which the rate of inflation can be brought down. 2 This may now seem obvious but at the time was not at all clear in Poland at the end of 1989, in view of unprecedented features of that stabilisation: disequilibrium relative prices and the unknown size of repressed inflation, which might have generated prolonged chaos instead of a relatively orderly bout of inflation; the combination of supply rigidities and the possible recreation of soft budget constraints, a potential recipe for protracted hyperinflation. Purely administrative price increases, below the market clearing level, of the kind introduced by the Romanian government, and in the Soviet Union by Premier Valentin Pavlov on 2 April 1991, arouse popular resistance and discontent without eliminating shortages; they may have some positive effect by inducing some supply response from farmers, reducing shortages, bringing down the ratio between black and official exchange rates, but otherwise are counterproductive in that they generate hostility against market reform.

There is another reason why all price increases (and compensatory payments) should be made all at one go: if price increases are diluted over time (as they were in Romania, through three stages of price liberalisation; to a smaller extent in Poland) the consequences are inflationary expectations, forward looking inflationary wage settlements, and a secondary wave of inflation that may set in motion an inflationary spiral.

Stabilisation needs prior or simultaneous monetary and fiscal restraint. Budgetary and monetary discipline is indispensable, otherwise the round of price increases involved by stabilisation is wasted, and inflationary pressures are continually recreated. Again, this may seem obvious enough but it is a lesson which was lost, for instance, on Soviet or Romanian leaders. In this respect Janos Kornai has been proven both right and wrong: wrong in that state enterprise budget constraints can be hardened, right in that this takes a non communist government aiming at restoring a private market economy.

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2. Shock therapy stabilisation should be distinguished from global shock therapy a' la Dornbusch (1990), which would include also instant privatisation through free handouts of capital to citizen, debt for equity swaps, instant total liberalisation of trade and capital movements, and more; and from the actual global shock therapy followed in Polish-type programmes which include free trade and convertibility as well as stabilisation.

An incomes policy, especially for workers and for farmers, is a necessity. In view of the underdeveloped monetary and financial system, monetary policy is not enough to sustain a stabilisation programme; incomes policy is also needed. Untypically this was recognised for Poland also by the IMF; the same principle was accepted in the CSFR, Bulgaria and - although not implemented - in Yugoslavia (December 1989) and Hungary (1991). The Romanian and (up to the Russian 1992 attempt) Soviet exceptions are a further confirmation of this principle. 3.

Contrary to the policy followed by Poland, farmers' incomes should not be penalised but protected instead (everybody else does it). Their loans should not be taxed (see below) but subsidised; they should not be charged international prices for their inputs when they face trade obstacles in selling their output at international prices and are facing the competition of subsidised imports.4 Paradoxically in Poland farmers' supply response was impeded by competition with food aid granted by the European Community and other donors in early 1990.

9. Monetary policy.

Anchoring a programme to real money supply can be inflationary; anchoring it to nominal money supply can be severely recessionary. Some programmes have avoided this dilemma through drastic reductions in the real money supply (Poland) or through ambiguity about whether money targets were nominal or real (CSFR; earlier Soviet programmes which were not implemented).

Real interest rates should be raised but not necessarily to positive levels during stabilisation. It is preferable to hold down interest rates initially, introducing some credit rationing instead. In a growing economy in conditions of tranquillity, of course, in equilibrium the real interest rate has to match the positive rate of return on investment. But in the turbulent times of transition a positive real rate of interest is highly recessionary, raises the burden of government debt service, and is probably unnecessary, as even a negative real rate

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3. On the importance of incomes policy in the stabilisation of transitional economies see Coricelli and Rocha, 1990.

4. I was once asked (by Gerhard Fink): why should farmers be protected and not, say, barbers? This is a good question, but has several very good answers: because it is easier to grow longer hair and beard than to go without food, because haircuts are non tradable and do not require tradables for their production, because haircuts are not capital intensive services both in terms of capital/output and capital/labour ratios.

may be sufficient to induce the public to voluntarily hold liquid monetary assets, especially in a situation where interest differentials between domestic and hard currency deposits are greatly in excess of differential inflation or likely domestic devaluations. If the government expects to get inflation down during the year, it should underpin that expectation by lending over the medium term at interest rates which embody that expectation of lower inflation and therefore lower subsequent monthly rates of interest, instead of lending mostly on variable monthly rates as it was done in Poland; (on possible perverse real interest effects, see Kolodko, 1990b and 1991).

<u>In no circumstances should interest rates be raised on old credit contracts stipulated at fixed rates</u>. Retroactive high interest rates are a tax on liabilities, a very bad tax which nobody has ever suggested. Assets, not liabilities, should be subject to tax. The increase in net wealth due to a drastic fall in the present value of liabilities may be subject to a capital gains tax, along with all kind of other capital gains - not liabilities as such. Retroactive interest rises are also unfair and arguably unconstitutional; they were disastrous for Polish farmers and literally stopped their supply response.

The same mistake might be repeated in Bulgaria, where raising interest on old contracts has been seriously considered. Hungarians have had a much better idea, namely raising the interest rate on enterprise payment arrears vis-a-vis other enterprises and the banking system, up to twice the 22% basic bank rate. However in Hungary in mid-1991 the marginal cost of borrowing to enterprises was of the order 30-40 per cent and therefore automatic borrowing at 44 per cent through cumulating arrears could still be preferred to negotiated borrowing at 40 per cent; twice the actual borrowing rate would be a preferable penal stipulation.

<u>A real wage level lower than actual (theoretical) levels, and consistent with the consumption available during stabilisation, should be strongly indexed</u>. This is the policy which was followed in Bulgaria. A weak indexation of the actual wage level - as it was done in Poland for the determination of wage norms - produces the kind of U-shaped time pattern of real wages that occurred in Poland in 1990. The reversal of excessive real wage falls then requires money wages rising faster than prices, but punitive taxation of excess wages above government guidelines can amplify the resulting wage inflationary shocks by raising more than proportionally enterprise labour costs. By itself, wage indexation is neither good nor bad; its effect depend on what wage level is being protected (which should not exceed what is allowed by sustainable consumption and its distribution), on the coefficient of elasticity of money wages with respect to prices, on the lag between price and wage adjustments, on the interval between wage negotiations (when real wage protection ceases to be automatic and money wages become entirely subject to renegotiation anyway).

10. International aspects.

Trade liberalisation makes an important contribution to stabilisation and reform: it conveys signals of opportunities for a more efficient pattern of imports and exports, it "imports" a system of relative prices for tradables which otherwise may be hard to settle at an equilibrium level following domestic liberalisation of prices, it enhances competition in an over-concentrated industrial system during the time it takes to partition it into smaller and competing units, it is a guarantee of decentralisation of enterprise decisions. Free trade leads to the overdue elimination of activities which would have a negative value added at world prices (which according to recent empirical studies may be as much as one fifth or one quarter of industrial activities in transitional economies), and therefore facilitates the restructuring process. However, free trade destroys also domestic activities which are unprofitable at world prices but still produce a positive value added and make a positive contribution to national income, employment, exports and consumption. This cost should not be neglected when deciding the degree of openness of the national economy during the process of stabilisation and transition to the market economy. Gradualism in stabilisation is not economically justified; gradualism in convertibility and trade opening until some progress is made in capacity restructuring is not necessarily unfounded - as long as the reform impetus is not lost on the way, as it might happen in Hungary.

There is a contradiction between the pursuit of generalised free trade and the will to join a trading bloc such as the European Community. Inexplicably this contradiction was little understood by central eastern European governments and impeded rapid progress in the negotiation of association agreements with the EC finally concluded in November 1991 by CSFR Hungary and Poland. Paradoxically these countries have had to reimpose tariffs in order to be able to negotiate their reduction in trade with the EC.

Internal convertibility for current transactions is within closer reach than previously thought. One of the reasons for Polish success in this area is the pre-existence of hard currency denominated assets and banknotes, mostly dollars, in the hands of households and firms on a scale which was unique in Eastern Europe (at 1-1-90 of the order of US$ 4.5 bn for households deposits plus US$ 2.5 bn for enterprises, plus cash estimated at between US$ 4 bn to US$ 8 bn). The possibility of early convertibility had not been at all clear in Poland at the time; indeed many economists had warned of the dangers of capital flight and loss of reserves, whereas the opposite happened. This does not imply that, in the words of the CSFR Minister of Finance Vaclav Klaus, "The only problem with convertibility is to declare it"; obviously there is no point in any exchange rate manoeuvre unless there are market-clearing prices, subsidies have been eliminated or very substantially reduced on tradable goods and services, and there is significant elasticity of demand and supply with respect to prices (see Nuti, 1991). In Poland the simultaneous price liberalisation and reduction of subsidies, and the presence of a significant private sector and the hardening of budget constraints in the state sector, ensured that these preconditions were satisfied (as they were in the CSFR on 1-1-91 when limited convertibility was also introduced, without a private sector and therefore with more limitations than in Poland).

<u>In heavily indebted countries the rescheduling of debt and capitalisation of interest, whether de jure or de facto, are a clear precondition for establishing convertibility.</u> Convertibility is immensely facilitated by the lack of externally held balances in domestic currencies (such as the sterling balances which marred British early attempts to return to convertibility). However convertibility is impossible without the freezing, or funding, or outright relief, of externally held debt denominated in hard currencies. Poland first rescheduled unilaterally, then came to agreed rescheduling, then benefitted from debt relief. Hungarians, pursuing convertibility under the burden of debt service, have faced great difficulties and have not yet established it.

<u>Debt rescheduling and relief should be requested before and not after stabilisation.</u> In the interest of the stabilising country, in order to bargain from a position of strength, the easing of the burden of debt should be made a negotiated condition for the introduction of convertibility and trade liberalisation; even after a very successful stabilisation such negotiations are held from a position of weakness. This is demonstrated by Poland's delay in obtaining debt relief and its uneven treatment by different creditors.

11. Exchange rate policy

<u>Some undervaluation of the domestic currency and a commitment to initially support a fixed rate are necessary to establish credibility of convertibility.</u> Through inflation continuously revaluing a nominally constant, initially undervalued zloty rate of exchange for the dollar, the real price of the dollar starts high and is continuously reduced in a kind of repeated Dutch auction until it finds its own equilibrium level, signalled by the nominal rate of exchange coming under pressure. Credibility of convertibility with respect to domestic holders of dollars as well as foreign and domestic firms is initially low, but it grows as convertibility is maintained. This gradual credibility enhancement allowed real appreciation of the zloty in 1990-91, which would not have occurred if the zloty had been initially set at a higher rate. Then the equilibrium rate can rise over time because of increasing confidence - up to the limits set by trade competitiveness.

Yugoslavia fixed a realistic rate of exchange which however could not be maintained - among other reasons - also because it was not undervalued 5; there is no point in introducing a convertibility which cannot be maintained, especially if there is a misguided commitment to fixed rates. An initial commitment to a fixed rate also enhances credibility (see Aghevli et al., 1991).

Undervaluation of the domestic currency may have to be well below Purchasing Parity Parities. In any case PPP is not a good guidance to initial rate for three reasons: the equilibrium rate is affected by stock equilibrium, which in Polish-type conditions may require a lower rate than flow equilibrium; PPP includes non tradables; more importantly, PPP is an average concept whereas competitiveness is a marginal one, i.e. what counts is the elasticities of supply of and demand for tradables.

Notwithstanding the need for some undervaluation of the domestic currency for the sake of credibility, the price of hard currencies should not be pitched as high as the level prevailing in the free market. The free price in a two-tier free/controlled market is always higher than the single price which would prevail in a completely free market. Some undervaluation is necessary but excessive undervaluation is expensive because it leads to distress exports and it worsens terms of trade. Excessive undervaluation, such as necessarily involved in officially adopting the free market rate, unnecessarily raises domestic inflation and, under the kind of wages policy followed in Poland, unnecessarily reduces real wages 6; thus it is to be avoided.

The nominal exchange rate, in any case, is a bad anchor if further inflation is expected and moreover cannot be controlled. This is what happened in Poland; the ensuing progressive revaluation to the point of gross overvaluation - partly the result of inflation generated by undervaluation itself - was as unfounded as the initial excessive undervaluation and required further (still inadequate) corrections. The later a new devaluation then occurs, as it eventually must, the larger it has to be, probably raising

5. In addition, of course, Yugoslavia was forced to suspend convertibility de facto in the Autumn of 1990 because by mid-1990 it had lost control of money wages, of monetary expansion and of republican contributions to the federal budget.

6. Gomulka (1991b) rejects the notion that the January devaluation was excessive on the ground that in December 1989 in Poland nearly 60 per cent of the total money supply was dollar-denominated, and therefore devaluation did not amount to a contractionary monetary policy. However he neglects that wages were not dollar-denominated, and that the inflationary implications of the January devaluation unduly depressed real demand through real incomes if not through real balances.

inflation and inflationary expectations more than a series of smaller adjustments. A combination of real wage policy and floating exchange rate (as in the Bulgarian programme of February 1991) or, better, some kind of crawling peg, appear to be preferable 7.

It is absurd to pre-announce devaluations. This was done in Czechoslovakia in mid-1990 for 1-1-1991 thus forcing an earlier devaluation in September 1990, in Romania for August 1991 and practically in Hungary with the January devaluation which had been openly called for by government members; but prior indication of general exchange rate policy is far better than maintaining an overvalued currency until a crisis occurs.

12. Privatisation

Privatisation takes a great deal of time to be implemented and/or to become effective. We already know from the privatisation experience of Western countries that the preparation of state enterprises for sale and the issue of shares to the public is a lengthy process (see for instance the British experience). The transfer of ownership titles can be speeded up by the free distribution of claims to state assets to the population, as envisaged everywhere except the ex-GDR and Hungary. This in fact may eliminate or at least reduce the need for prior financial and capacity restructuring, capital valuation and share issue pricing. However the organisation of even such "free" transfers has proven inordinately time consuming in practice, and has not yet been implemented in any of the transitional economies in spite of earlier commitments. In any case the simple transfer of ownership titles has no effect whatever - other than an undesirable inflationary wealth effect on demand - in the absence of properly functioning financial markets: for managers to be subject to stock market discipline it is necessary for them to feel the threat of takeover in case of poor performance. Restrictions on voting and on early

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7. Aghevli et al. (1991) discuss the relative merits of fixed and flexible exchange rate regimes in developing countries. On the one hand a commitment to manage the exchange rate flexibly may provide helpful assurances to producers of traded goods and thereby support external adjustment; on the other hand, it may undermine the credibility of the government in adopting restrictive demand policies and thus make it more difficult to lower inflation without imposing an output cost. On balance, they recommend a nominal exchange rate rule, under which the rate of crawl of the nominal exchange rate is fixed. Following this line of reasoning it was effective for Poland to maintain a fixed nominal rate for an initial extended period, to establish credibility, but the continuation of such policy after credibility had been established will have had advantages outweighed by disadvantages with respect to exchange rate flexibility.

resale of shares, and the pulverisation of shareholding, are a guarantee that financial markets will not be able to exercise a function of corporate control for a long time to come.

<u>Privatisation, because of its necessary slowness, should not be relied upon as a way of easing the task of stabilisation.</u> "Small scale" privatisation (housing, catering and trade establishments, land) can be much quicker than the privatisation of state enterprises, but even that cannot soften the blow of instant price liberalisation, unless it starts beforehand and its progress is clearly and credibly announced in all its details. It follows that the Shatalin-Yavlinsky Plan of September 1990 for Soviet stabilisation in 500 days was not credible, because of its attempt to reduce the overhang through front loaded privatisation. Soviet reform attempts of end-1990/early 1991 failed not because privatisation per se was not introduced, as Jeffrey Sachs argues (in Repubblica, 8 March 1991), but because privatisation was relied upon as an instrument of stabilisation - already a tall order - and was not replaced by other stabilisation measures such as higher prices or taxes.

<u>Property restitution to old owners is a respectable political objective but is economically costly.</u> Restitution, introduced everywhere following the ex-GDR lead, is not economically necessary to build up confidence in the new institutions, since there is no expectation of policy reversals in the target system. It slows down further the process of privatisation because of the time needed to allow and process claims, especially if restitution in kind is contemplated. It also absorbs precious time to settle a large number of issues: the eligibility of nationals versus expatriates (and from what date), the fixing of ceilings and progressive scales for compensation (always confiscatory on a progressive scale - a residual of socialist egalitarianism); the fixing of arbitrary dates from which nationalised property is to be returned to old owners, and often of specific nationalising laws and types of property. Restitution to old owners, including aristocrats and the Churches, at a time when considerable sacrifices are asked of ordinary citizens and workers, is politically divisive. These economic costs may be regarded by the governments involved as worth paying (in Hungary, restitution was a condition of the Smallholders' Party essential participation in the government coalition), but should not be neglected.

<u>The state sector, which in the necessary delays of privatisation continues to exist and to provide the bulk of productive capacity, should not be ignored, neglected and penalised.</u> Central eastern European governments, particularly the Polish government, confuse their potential ability to privatise with the realisation of that potential

and simply pretend that the state sector does not exist. 8 Worse, state enterprises are in Poland subjected to distortionary and discriminatory taxation with respect to the private sector, such as the tax on wage payments above statutory guidelines (the so-called PPWW) and a payment of a so-called "dividend" to the state budget calculated not on profits but on a revalued historical capital value; similar policies are followed, to a lesser extent, in the other countries. It is inappropriate to enforce incomes policy only in the state sector; a generalised progressive income tax is preferable. The argument of lack of owners' control over wage expenditures in the state enterprises is used in support of excess wage tax in Poland and Hungary but this is a case for privatisation and for the overhauling of managerial incentives in the state enterprise sector, not for tax exemption of the private sector.9

On the rebound from former "soft budgets" state enterprises are indiscriminately starved of resources, whether from the reinvestment of profits or access to credit, regardless of the viability of potential investment. Under the prospect of a rapid privatisation which does not however materialise, there is hardly any reorganisation, redeployment of productive assets within the state sector, revision of methods of assessing and rewarding managerial performance. Managerial uncertainty about the prospect, timing and terms of their enterprises' privatisation leads at best to paralysis, at worst to de-capitalisation, anarchy and rapid decline. This kind of policy is not necessarily an improvement on the former central tutelage 10. The only incentive for efficient managerial behaviour is the prospect of finding a foreign buyer or partner, and this is not general enough or, apart from exceptions, strong enough to vitalise state enterprises.

Under the old system state enterprises were basically administrative units executing central instructions and rewarded or penalised according to the degree of fulfillment of such instructions. This, however, does not necessarily

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8. In this the new governments display the same kind of attitude that the old regime had with respect to inflation, confusing their potential ability to implement price stability with the realisation of that potential, and ignoring the cumulative build-up of the large monetary overhang which played such a great part in systemic failure.

9. Polish government documents (for instance the Government Memorandum of 25 March 1991, section IV.1) candidly recognise that the "popiwek" tax is "expected to provide a significant incentive" for privatisation. Surely this kind of incentive should not be needed, or less distortionary incentives could be provided.

10. On the negative perception of the Polish stabilisation programme by managers, from a sample of 70 state enterprises, see Maj 1991.

imply lack of "entrepreneurship" on the part of managers; indeed it has been argued that the task of running a state enterprise in the face of continuous unpredictable changes in often conflicting central instructions, in conditions of endemic shortages of labour and means of production and uncertain supplies, is a much harder challenge than that faced by western managers running a private enterprise in a market economy. The problem is not the absence of entrepreneurship but the misdirection of whatever entrepreneurship is there. There are signs that state enterprises have actually responded to some extent to the new conditions; a pilot study of Polish state enterprises conducted by the World Bank (Jorgensen et al., 1990) concludes that "in the light of the immense and continued uncertainty and the time necessary for adjustment, the degree of response observed was high, and in most cases in the right direction". However, some of this response had negative side effects (for instance, the growth of inter-firm payments arrears, which firms expected to be somehow guaranteed by the state); excess wage tax proved to be constraining output and generating distortions; firms suffered from a "vacuum of ownership"; "the best-placed firms are probably those with previous exposure to selling on Western markets". It is urgent to provide new indicators of enterprise performance, budgetary constraints (e.g. cash limits) and an appropriate system of managerial incentives (rewards and penalties geared to market success).

Especially in the state sector some capacity restructuring should be steered from the start, following the kind of industrial policy which is usually formulated and implemented in all other market economies. When, as in Poland in January-March 1991, enterprise profits are subject to 87 per cent taxation and access to credit is restricted in principle, there can be no supply response from any stabilisation programme.

13. Sequencing, announcements, contingencies.

<u>Speedy action is better than orderly procrastination.</u> In recent literature there has been considerable discussion of the question of appropriate sequencing of reform and stabilisation steps: some have pointed out the high degree of interdependence of tasks and therefore the need to do everything at once (e.g. Dornbusch 1990); others have attempted to draw a desirable sequential critical path (e.g. Nuti, 1991b). There is now, however, widespread agreement that, whatever the merits of a possibly potentially superior critical path it is much more important to move as fast as possible "meandering" in the right direction than to make slower progress along a sequentially optimal path, even if it existed. Clearly stabilisation must come first, as market clearing prices without excessive inflationary pressures are a precondition of viability of any system where markets are used at all, even if only for the distribution of resources and not their allocation as in the traditional centrally planned economy. Currency

convertibility without price liberalisation (even solely for the tourist rate, as it was done in the Soviet Union in November 1991) unloads the monetary overhang onto that one market and leads to costly and absurd results (such as a Soviet average wage of the order of US$ 3 per month). But it is essential that central eastern European governments should not stop after stabilisation wondering what is best to do next, and should keep going. In Poland institutional reforms practically came to a standstill in the first half of 1990 for a considerable time, while privatisation was unnecessarily delayed by political arguments and by the pursuit of facile schemes of mass privatisation. Without such gaps and delays the expected supply response might have been stronger. Of course complex and unprecedented systemic reform is bound to take time; but, confronted with such delays, it may be better to follow the line of least resistance and implement what is immediately feasible, rather than follow a rigid ideal pattern of reform sequencing: bad sequencing may be better than no change.

<u>Even incomplete and unsuccessful attempts at reform may have positive effects.</u> It has been claimed that such attempts have brought about "reform fatigue"; certainly the repeated pre-1989 aborted attempts at constructing a market socialist model must have worn out all those involved. However even failed attempts are not necessarily a waste of time. It helps stabilisation to have, beforehand, a private sector in agriculture and in manufacturing; some free trade in foreign currency, currency retentions by exporters and currency auctions (admittedly distortionary, but a powerful instrument of decentralisation and an incentive to trade); a previous banking reform, legislation of the kind already passed in Poland under Jaruzelski, even under Martial Law.

<u>In the delay of implementation the effects of time-consuming measures can be approximated by making credible and detailed announcements.</u> Thus, for instance, the effects of a necessarily slow privatisation programme - on saving behaviour, on incentives - can be accelerated by announcing the exact terms, schedule and procedures of the entire programme. However, this presumes that the path to be followed is clear and widely agreed, and that the government enjoys credibility when it announces what it intends to undertake next. Policy reversals or even continuous piecemeal alterations within the same general policies undermine such credibility.

<u>Instead of adopting a single package of stabilisation measures, the government should make contingent commitments to cover possible undershooting or overshooting, and some of the possible additional external shocks.</u> A single package could not possibly be "robust" enough with respect to exogenous factors and to unpredictable behavioural responses. Once a package is announced, if external or domestic conditions change in an expected direction the government is paralysed, for fear of destabilising expectations by taking necessary action. For instance the Polish government could not react to the recessionary

overshooting of its stabilisation plan in 1990, fearing that reflationary measures would signal the abandonment of its commitment to austerity. Only the prior announcement of contingent measures, at the same time as the stabilisation was announced, could have avoided keynesian unemployment, which is not as justified as the unemployment generated by capacity restructuring.

14. System specific features of stabilisation.

Post-communist countries are different from ordinary underdeveloped countries; high costs can derive from neglecting such differences. In the elation of 1989 revolutions the prospect of an early transition to capitalism induced new rulers, international agencies, western governments and their advisors to forget the heavy burden of the former regime's legacies. Not only were older historical legacies initially neglected - nationalist and ethnic conflicts, to name only the ones which most spectacularly manifested themselves soon afterwards - but also the more recent but deeply ingrained economic legacies of habits, institutions, expectations.

By and large central eastern European economies have been treated like ordinary developing countries, facing familiar tasks of de-regulation of economic activities, privatisation of state assets, coping with a large external debt, trying to bring down inflation and hyperinflation, opening their economies to trade, attracting new foreign investments. The skills of area studies specialists and of economists expert in centrally planned economies and their long path to reform were regarded as obsolete. Knowledge of the target model was regarded as the only necessary qualification to manage the transition to that model.

Qualitatively the tasks of transition are the same as, or similar to, those familiar from the experience of underdeveloped countries. But one might be forgiven for quoting Engels' proposition that quantitative differences can become qualitative (Anti-Düring): the sheer scale of these tasks, as well as their simultaneous presence, reduces very greatly the relevance of the stabilisation and reform programmes of underdeveloped countries to central eastern Europe. Moreover, the ultimate difference between the two groups was neglected or underestimated: namely, the extraordinary economic inertia of a centrally planned economy no longer subject to central control but not yet fully subject or responsive to full market stimuli.

There is an inordinate difference between reducing the size of the state sector, say from 60 to 30 per cent, and reducing it from 100 to 50 per cent; for a start, one has to introduce from scratch property legislation, joint stock companies, commercial banking, financial markets, price competition, liquidation and bankruptcy; legislation takes time, jurisprudence a much longer time. There is the same difference between raising unemployment, say, from 5 to 10 per cent and raising it from zero to over 10 per cent; between liberalising some price controls, and replacing with market clearing prices a historical stratification of multiple prices varying according to agents and type of transactions; between introducing convertibility for a domestic currency and introducing a true domestic currency in place of what was essentially a unit of account or, at best, a lottery ticket. The list could go on. The neglect of these differences had led to a serious underestimation of the time scale of transition and of the costs of a transitional economic non-system, and to a serious overestimation of the supply response that could be elicited through familiar policy instruments in an inert economy 11.

15. Costs and benefits.

The benefits expected of stabilisation and reform need not emphasising: the viability of markets, which for consumers means a return to "normal life" (a theme which has frequently recurred in electoral campaigns) and for firms the elimination of the most glaring inefficiencies; the de-politicisation of economic activities; the establishment of market discipline for enterprises and personal incentives for individuals; a return to the world economy and in particular to Europe; the expectation of better standards of living.

The list of expected benefits is long but, when there is no alternative course of action the benefits of the only course do not even need to be mentioned, let alone quantified. There remains however a problem of cost-effectiveness of alternative ways of taking the same course of action (i.e. not a question of what to do but of how to do it).

The stabilisation and reform plans of central eastern European countries have been accompanied by inordinately high costs, in terms of employment, output, consumption, distribution of income and wealth.

Some of those costs have nothing to do with the transition to market but are simply the open manifestation of the hidden costs of the earlier system: hidden unemployment and inflation, environmental disaster, inappropriate capacity; such costs would have been openly incurred, sooner or later, whatever the target model selected.

Some of the costs have been the result of the uncoordinated nature of stabilisation and reform plans undertaken in the whole area, which have resulted in the collapse of trade within the ex-CMEA. These costs could

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11. The specific features of stabilisation in post-communist economies, however, are well understood in Kolodko 1990a and 1991; see also Nuti, 1991.

have been at least alleviated if the countries concerned had been able to agree on establishing free trade areas or on setting up schemes for automatic trade clearing and mutual payments of the type adopted through the European Payments Union (EPU) in post-War Europe (which would have attracted Western aid just as EPU attracted Marshall aid). Keenness to undermine Soviet dominance, to make a clean break with the past, as well as fear of delaying the more desirable course of joining the European Community, have resulted in the otherwise avoidable costs of trade collapse within the ex-CMEA. Similar costs now might be incurred if the ex-Soviet republics failed to establish a trade and payments regime capable of handling their interdependence and preserving viable trade flows.

Some of the costs of "transition" have been the result of the sudden opening of national economies, due to i) the lack of protection of those activities which - with the benefit of hindsight - we now know should have not been undertaken in the past but, being there, were still making a positive contribution to national income; ii) the related costs of a speedy convertibility. Of course there were also benefits from opening the economy, like the expected gains in trade, competition and foreign investment, listed above; we cannot say much about the magnitude or even the sign of the net result.

Partly, some non negligible costs of stabilisation and reform plans undertaken in central eastern European countries have been the results of true and predictable mistakes, in the narrow sense of decisions which can be proven wrong under any circumstances, rather than plausible "quasi-mistakes" in the sense of decisions which proved to have been inappropriate only with the benefit of hindsight and therefore can generate "surprises" 12. Using President Bush's language, these are "the wrong kind of mistakes" 13.

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12. Recently there has been a tendency in official circles to recognise Polish overshooting and the negative phenomena associated with it, but to claim that these had been "surprises" (see Gomulka, 1991a and 1991b) and to dub economic decline and unemployment with the dubious euphemisms of "creative destruction" (Gomulka, 1991b). Moreover Gomulka also admits that "some of the forecasts, e.g. on prices and output, were made under the pressure of policy convenience" (1991a), i.e. were actually fabricated. One might have been "surprised", perhaps, by the results of the stabilisation plan in January 1990, but not in February 1990 (when I actually had the privilege of making these same points to Minister Balcerowicz), let alone in April-May 1991.

13. "As Yogi Berre used to say, I do not want to make the wrong kind of mistake" (President George Bush discussing with journalists his cautious attitude to Soviet crackdown in Lithuania in January 1991).

Thus, for instance, in Poland it was a mistake to let real wages and the real rate of exchange float at random with the vagaries of inflation, to excessively over-devalue the zloty only to let it steadily overvalue, to effectively tax old loans by raising their interest rates, to neglect farmers' incomes and supply response, to neglect the state sector, to postpone further institutional changes, not to make clear announcements about further developments, to make no provision for possible overshooting.

The inability to recognise mistakes and to learn from them, which was a main drawback of the old system, seems another legacy inherited by the new system. What is worse, central eastern European governments often fail to learn not only from the mistakes of others, which is true wisdom, but even from their own.

Table 1: Stabilisation and Reform Programmes in Central-Eastern Europe.

Feature	Yugoslavia	Poland	Romania	CSFR	Bulgaria
Start	1.12.89	1.1.90	1.8.90	1.1.91	1.2.91
Price liberal-isation	instant 90%	instant 90%	3 stages	instant 85%	gradual
Subsidy reduction 1989/1991	yes	17.4-4%	partial	16.1-4.6%	16.7-3%
Fiscal squeeze	temporary	yes	no	yes	limited
Monetary restraint	temporary	yes	no	yes	limited
Currency devaluation	yes	yes	yes	yes	yes
Foreign trade liberalisation	extensive	extensive	v.limited	extensive	v.limited
Internal convertibility for firms	yes;aborted	yes	end-1991	yes;delayed	yes
Internal convertibility for households	yes;aborted	yes	no	no	no
Wages policy	yes;ignored	fiscal	no	yes	yes
Small-scale privatization	yes	yes	yes	yes	slow
Sale of state enterprises	some	some	mostly land	slow	slow
Property restitution	no	yes	yes	yes	yes
Mass privatisation through vouchers	no	delayed	delayed	delayed	delayed
Capacity re-structuring	no	little	no	little	no
Real anchoring		M,r		M,r	
Nominal anchoring	W,i	W,e		W,e	M

Note: M=Money, r=real interest rates, W=wages, i=nominal interest rate, e=exchange rate

Table 2: Key macroeconomic variables in Central Eastern European Economies (percentages)

	(1) Rate of GNP growth			(2) Overall government balance/ /GNP	(3) Inflation rate		(4) Rate of unemployment	
	1989	1990	1991	1990	1990	1991	1990	1991
Bulgaria	-0.4	-13.6	-23	-10	65	447*	1.6	10
CSFR	-0.7	- 3.1	-14	- 9	10	58	1.0	8
Hungary	-0.2	- 5.0	- 7	- 2	30	38	1.7	8
Poland	-0.2	-12.0	-10	-4	250	60	6.1	11
Romania	-5.8	-7.9	-18**	-6	40	291*	1.3	4
Yugoslavia	-6.6	-8.0	-20	n.a.	583	235	13.6	15

	(5) Current account balance/ /GNP	(6) Monetary overhang		(7) Net foreign debt/hard currency exports	(8) Foreign exchange reserves/ /Imports
	1990	Jan 1990	Jun 1991	1990	1990
Bulgaria	-6.3	small	zero	497	31
CSFR	-2.5	small	zero	116	26
Hungary	0.3	zero	zero	328	19
Poland	1.1	significant	zero	408	53
Romania	-4.8	small	small	35	27
Yugoslavia	-7.1	small	significant	75	34

* November (twelve previous months)
** Industrial output

Note: This table has been compiled from official statistical sources and the ECE-UN Economic Bulletin for Europe, 43, 1991. Inflation rates are point-to-point rates of change.

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