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In this book, Kazimierz Z. Poznanski offers an integrated study of institutional change in the Polish economy since 1970. He examines the economic peak of the communist phase, the decline of the system, and the post-communist transition since 1989. Taking his analytical framework from evolutionary economics, he provides a complete reevaluation of conventional views of communist economies and the post-communist transition. The book presents the communist economy as subject to major changes, particularly due to political pressures, and interprets its economic difficulties as related to underlying systemic decay. The economic 'shock therapy' of 1990 is seen as very much a continuation of earlier trends and pressures, which has led to probably an even deeper, though brief, economic collapse. This book will be of interest to economists and political scientists concerned with institutional transitions, as well as to students of East European and post-Soviet studies.

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Preface

This book has taken a number of years to finish and in retrospect, it is hard for me to recall when the whole project began. It goes back at least to my days at Cornell's Economics Department. At that stage, when I was doing my visiting lecture on communist-type economies, my insights were mostly straight out of a textbook, but the research that I was doing was drawing me away from the conventional thinking. I have continued my search for a fresh look at the system and, since it collapsed, have applied the same approach to the post-communist transition. My book presents this alternative view through an in-depth examination of Poland's economy during 1970–1994 period. While at Cornell, I gained greatly from close cooperation with Jan Svejnar and Kathy Terrell, colleagues on a joint project about Poland's economy during Gierek's reign. I made another major step in my research along the same lines while on a fellowship at Stanford University. My efforts gained from encouragement and comments by Ellen Comisso and Laura Tyson, who published my research results in a book collection printed by the Cornell University Press. Invaluable has also been help from Paul Marer, with whom I have worked on a number of projects, including a study of the impact of foreign debt on Poland's economic growth after Gierek (this during my brief teaching appointment at Northwestern's Economics Department). I am also much indebted to Michael Montias, whose fine art of comparative economic analysis inspired a number of my own empirical tests of Poland's economy (whose early postwar decades he examined in a seminal volume published by the Yale University Press). I benefited enormously from my many exchanges with Janos Kornai, whose work seems closest to my alternative framework for studying communist and post-communist economies. While developing this, as I call it, evolutionary, framework, I have drawn from my frequent discussions with Peter Murrell. Josef Brada has critically read a number of my

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drafts, since incorporated into the book. Jacek Kochanowicz has commented on parts of my manuscript, as has Stan Gomulka, always eager to pass on a valuable comment. Grzegorz Kolodko and Danuta Gotz-Kozierkiewicz have been most helpful in leading me through the vagaries of Poland's most recent economic developments. My faculty colleague at the University of Washington, Dan Chirot, and Ken Jowitt of UC-Berkeley have been helpful, particularly with regard to my forays into political issues. But, by and large, this book has involved a lonely struggle with the rapidly changing and complex picture of the Polish economy. For this I have needed a lot of persistance and peace of mind, both only possible because of the support of my wife, Joanna, who collaborated on two smaller themes touched upon in my book. And now that the book is finally finished, I hope we can go for longer walks with our brown-haired dog.

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Introduction

Research agenda, conceptual model and principal findings

This book argues that the post-1970 period in Poland's economy has been characterized by the relatively slow, often inconsequential, disintegration of the planning regime and the parallel reemergence of capitalist markets. Much of this systemic transition has been brought about unintentionally by the communist leadership responding to a variety of pressures coming from a disaffected society. The mid-1989 negotiated relinquishment of political control by the communist party did not mark the end of this institutional transition, but it did accelerate it by opening additional avenues for reform. The lengthy, still unfinished, process of remaking the economic system has weakened the mechanisms of coordination and ownership structure through most of the period in question. This institutional deterioration in the dominant state (= public) sector is here found to be one of the main reasons for Poland's volatile pattern of economic development, marked, among other things, by severe crises in 1979–82 and 1989–91.

Our particular interest is in explaining the period between 1979 and 1991, when Poland's economy experienced severe imbalances, extensive aging, and no real growth. We consider this general condition one of the most intriguing features of the whole period studied and also one that distinguished Poland from the rest of the region. We call this phenomenon 'growth fatigue' to separate it from other types of economic adversities that are either cyclical or caused by external shocks (e.g., in bank credit supplies, commodity prices). Growth fatigue is defined as a combination of economic stagnation and internal instability (manifested in shortages and/or open inflation) resulting from a serious decline in economic institutions, i.e., incentive structures and information quality. It is this institutional nature of growth fatigue that accounts for its durability, because restoring systemic efficiency is typically very time-consuming.

We also argue in this book that the post-1992 economic recovery that

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seems to finally be taking the economy out of its growth fatigue condition, can similarly be explained in institutional terms using a conceptual model applied to analyzing the previous years. While the transition process to capitalist markets is not yet finished, there has been a major shift in the direction of this change. After years of institutional deterioration, Poland's economy has recently begun improving its institutional setting. The public sector has seen its system solidified, but far more important has been the rapid replacement of that sector with the private one. While the system has remained mixed, the private sector, with its superior set of economic rules, has become dominant, and, as such, and largely by itself, this sector was capable of lifting the economy out of the 1989–91 crisis.

With its focus on systemic factors, our analysis could be considered an exercise in institutional economics, or, given our interest in the plan-market alternative, a study in comparative economic systems. By economic system, on which such analysis concentrates, we understand here the rules by which principal agents abide in their pursuit of economic objectives. The rules can be best viewed as constitutive constraints on choices and actions taken by agents when coping with production processes, themselves subject to their own constraints – related to scarcity of physical factors. One component of rules refers to the coordination mechanism – linking individual agents – and the other to property rights, which provides the motivation matrix for those actors. The systemic rules of the game can be either formal (= impersonal) or informal (= personal), the former forming a structure and the latter representing what could be called the meaning of a given institution.

The pattern of Poland's institutional development uncovered in our case study contradicts on numerous accounts the conventional thinking on communist-type economies, in particular the prevailing paradigm offered by the so-called totalitarian school. The core ideas of this basically political theory were formulated mainly by Arendt (1968), and Friedrich and Brzezinski (1956). But our findings also seem to depart from another prevailing approach, that of the modernization school, which can be linked to the works of such political scientists as Black (1966) and Jowitt (1971, 1978) (who in his later work on what is called Leninist-extinction took a different position; Jowitt, 1992). While formulated as political theories, they have also greatly influenced economists' thinking on institutional analysis – particularly with respect to totalitarian arguments on the nature of communism.

This study, in particular, contradicts the totalitarian argument on the

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static nature of the communist economic system, i.e., on that system's nonreformability (which applies even more to the communist political system). Rather than finding the system unable to afford any substantive change, we show the system as slowly moving through a number of major modifications. In terms of the totalitarian paradigm, it would follow that since the communist system supposedly caused social problems to infinitely compound, its collapse had to be revolutionary in character, most likely with elements of violence, but the transfer of power in mid-1989 was orderly and peaceful. Rather then seeing some momentous change in the aftermath of that transfer, one finds the postcommunist economic system changing at a relatively slow pace, with many elements of the past still in place or just marginally altered.

Unlike the other major current in communist studies, the modernization school views the whole system – including its economic component – as dynamic and moving towards a state of normality, seen as a routinized communism (or some sort of more efficient mixed system of neither communism nor capitalism), but we offer here ample evidence that the economic system was instead deteriorating, or becoming increasingly dysfunctional, while at no point of its whole long existence representing an efficient alternative to the capitalist-type order. When extended to the postcommunist stage, this key approach does not stand up well to empirical tests either because, rather than to see further progress in moving to a normal state, the Polish economic system almost immediately experienced further degeneration, particularly in the still dominant state-owned (although now only nominally state-controlled) sector. And it is exactly this institutional deterioration that became one of the critical sources of the second – 1989–91 – economic crisis.

Our empirical findings are consistent, however, with the evolutionary approach – with its roots in economics – which views social systems as complex or living structures that are permanently undergoing change and which, indeed, exist because of change. Since the communist order falls in that category, one is not surprised with the large amount of substantive change that happened throughout the years of its existence. Within the evolutionary paradigm, any change – including this, entailing economic systems – is assumed to be an open-ended process that can either take a progressive direction or lead to a regression. This open-endedness would account not only for the installation of the state-managed system as an inferior alternative to the market-type system, but could also explain what we have discov-

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ered to be the regressive trend in system's evolution under communism, as well as the fact that in the first postcommunist years, the economy went through another loss of systemic efficiency as well.

It is not that we have taken a finished paradigm and applied it to our case study, since this approach is still very much in the making. Nor have we been able to build heavily on the existing comparative literature, because to date there has been little effort made by the economic theory of communism and postcommunism to absorb evolutionary ideas or concepts (while some of the successful applications have not explicitly referred to the paradigm). Thus, in great part, we had to develop the theoretical model for our study, and the study, in turn, provided a test of its validity. We outline that general approach to institutions in this introductory part of the book and then make various methodological statements later in the book. But we offer no exhaustive review of the evolutionary perspective and instead refer interested readers to our other recent work dealing more extensively with that subject (for instance, see Poznanski, 1995c).

Evolutionary approach

Many elements of the evolutionary approach relevant for students of the communist and postcommunist economies were formulated in the twenties and thirties, when economists such as Mises (1920) and Hayek (1935) tried to prove that the state-controlled economy is infeasible (with Lange (1935) and Dobb (1935) taking an opposite stand from neoclassical and marxist perspective respectively). This argument was grounded in a broader framework, whose original intent was to correct mainstream neoclassical (= liberal) economics rather than to confront Marxism, which claimed that the state-only (no-market) system is not only possible but also of superior efficiency and higher justice. Another key contribution to that broader body of theory came from Schumpeter (1939, 1942), though while in agreement with the main tenants of the evolutionary argument developed by Mises and Hayek, Schumpeter – not a party to the original debate – was of the view that, though inferior on both these accounts, a state-controlled system is feasible.

It should be kept in mind that while Hayek and Mises were primarily addressing the question of the feasibility of state planning as attempted by the Soviet Union, Schumpeter took a broader view. His prediction referred to various forms of state-dominated systems, i.e., that of the Soviet state-bureaucratic system, as well as the national-socialist model tried in Nazi Germany, and also the welfare state

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evolving at that time in Great Britain. The real focus of Schumpeter's work was the lattermost model, where, as he saw it, labour unions captured state power and used it to forward their own interests. The decline of the Soviet version partially vindicates Mises and Hayek by showing that at least in the long run, the system was not viable, while the demise of the national-socialist model does not support any of the positions, for it was caused by external factors (losing the war), and the durability – and popularity – of welfare states in the contemporary world directly supports Schumpeter's position.

The ideas outlined by these first evolutionary scholars have been expanded upon by a score of contemporary theorists including Nelson, who, among other things, has developed (in tandem with Winter, 1982), a formal model of an evolutionary enterprise, one which is assumed to be constantly searching for relevant data rather than passively using information for decisionmaking (this integrated with a macroeconomic model of evolutionary growth, where diffusion of information – technology – is a prime driving force). In this line of work, drawing mostly from Schumpeter and the organizational theorist, Simon (1947, 1957) (with little mention of either Mises or Hayek), Nelson has concentrated on the capitalist system. For a long period of time, the potential validity of that model for studying the real communist system – its state enterprises and national growth – has not been widely tested (early exceptions include Murrell's (1990b) study of foreign trade patterns, and Poznanski's (1989a) research on innovation aversion under a state-planning regime).

Evolutionary economics entered the field of comparative studies more broadly only after the collapse of the state-planned system. The main reason for this wider reception, however, has not been the application of this economic paradigm to studying communism itself, i.e, its past, but rather to analyzing its aftermath. We are referring here to the then raised main question of an optimal – in terms of both time required and costs to be incurred – path of transition from communism to capitalism. The evolutionary perspective has been employed by a group of economists arguing for a gradual programme of economic reforms, one that would rely on voluntary – spontaneous – actions taken by individual actors and against radical methods based on the forceful application of abstract, blueprint, ideas by a state committed to mass-scale and short timetable reforms (for such an evolutionary perspective, on reform see Murrell 1991, Poznanski 1992a; 1995a, Stark 1992).

But the evolutionary paradigm can also be used to examine the

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communist period, a good, if rare, example of such application being the work by Kornai (1990a, 1986) on the late so-called reformed communist (or, as he prefers to say, socialist) economy, where the spontaneous nature of systemic change is stressed. Such affiliations are also visible in Kornai's recent summary work on the communist system, including his redefinition of economic systems as being deeply embeded in the political structure (see Kornai 1992b). While only in this late analysis Kornai directly refers to the evolutionary framework, it might be argued that the bulk of his work on comparative systems is crafted in that economic tradition (see Poznanski 1995b). This includes his anti-equilibrium argument against neoclassical understanding of how market operates (Kornai 1971), as well as the related theory of shortage economy (Kornai 1980).

Economic institutions

To further clarify, the evolutionary theory is one that – following classical economics – considers the single individual as most central to economic analysis (rather than class, as in the anti-classical Marxist approach, or the nation/state, as in pre-classical mercantilism, for more see Poznanski 1995c). But, unlike in classical economics, the evolutionary ones does not assume that the individual is perfectly rational and thus that economic processes are totally deterministic. While in the classical formulation, individuals make choices on the basis of perfectly clear options – and opportunity costs involved – in the evolutionary approach, it is more legitimate to talk about human actions, through which much necessary information is discovered. Within the evolutionary model, an individual operates, as Hayek stresses, in an intentional rational way under conditions of incomplete information with the result that actions are only quasi-deterministic (with eventual success reflecting effort as well as luck) (Kirzner 1992).

While in the classical model, the greatest barrier to the individual pursuit of economic objectives – profits, wealth, or happiness – is a shortage of productive factors such as labour and capital, in the evolutionary approach, it is lack of full information. It follows from that above proposition that it is not so much the effective allocation of physical resources, as understood by classical economics, but rather informational efficiency that primarily concerns the evolutionary theory. When information is scarce, then the individual agent is uncertain and this uncertainty influences the valuation of alternative courses of action. Indeed, at certain levels, this uncertainty may cause

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the individual to entirely forego an opportunity to mobilize his productive resources for some practical use. In this sense, possessing good information – and bringing uncertainty to tolerable ranges – constitutes a more fundamental economic problem than having access to productive factors.

Evolutionary economics also assumes that most of the information is possessed by individuals and in a form that makes it often impossible to communicate (Lavoie 1985). This type of information, often called technical or tacit, cannot be properly communicated because it is not easily separable from an individual's experience and the specific conditions under which it was accumulated. Certain nuances of this private knowledge are easily lost when articulated by the source person, but these details can also be missed through improper interpretation by receptors. To be more precise, such type of idiosyncratic information can be transferred but only under very special circumstances, where intimate personal contacts are allowed to develop over an extended period of time and where frequent observation – rather than instruction – helps to reveal the contents. Consequently, the best application for such tacit-type knowledge is for individuals to use it by themselves whenever they find it appropriate.

One principal method, or instrument, for maximizing the stream of information is to build economic organizations that can be viewed as entities for processing information, or, more specifically, for both retaining useful information and finding additional information. Their principal role is to economize informational processes, a point reflected, for instance, in Nelson's definition of an enterprise as a set of so-called routines. Routines are the established rules of decisionmaking that allow members of an organization to reduce the costs of processing information for each choice faced in their daily affairs. These routines are cost-reducing since they operate as subconscious patterns of behaviour that help individual members respond to changing conditions without overloading their limited computational capabilities. As such, routines can be fairly considered the most essential organizational asset and thus the one least amenable to change as well.

While organizations are players, it is institutions, as more general unintentional arrangements, that provide the rules by which organizations play. Similar to organizations, institutions are information processing devices, and this applies as much to the capitalist system as to the communist one. As a coordinating mechanism, the capitalist system serves as a devise for processing information, or, as Hayek (1988) calls it, is a discovery process. Coordination under central planning serves

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same purpose of bringing information into economic decisionmaking, though here the major vehicle for relevant information is not competitive prices, as in the market economy, but bureaucratic commands (= directives). The function of the other systemic component of the capitalist economy, i.e., private property, is, in turn, to provide incentives for both searching for information as well as releasing it to other economic players, and a very similar role is played by public property in the state-controlled economy.

With this difference in informational procedures – horizontal flow under the market as opposed to vertical flows under planning – comes the difference in the cost of processing information. Similarly, with various types of property rights – private property under capitalism and public ownership under communism – comes disparity in informational costs. Since processing information is the basic function of any economic system, it follows that systemic differences can be best measured in terms of their respective information cost, and the evolutionary theory claims that the capitalist system is superior to the communist-type economy exactly in those informational terms. While the competitive market is the least costly coordination procedure since it automatically engages all players at their source, private property produces the strongest incentive to share information (as such release is a precondition for concluding any voluntary commercial contract).

Institution building

While classical economic theory does not explain how social institutions emerge, change, and decline, evolutionary economics does offer such an explanation. In fact, classical economics has no true theory of institutions at all, because they are assumed perfect, meaning that information – on producing and transacting – is complete and cost-free. Such a theory is provided by the neo-institutional approach, which builds on certain classical assumptions (including the concept of rational agent responding to resource scarcity as it is reflected in relative prices) while also assuming that economic institutions matter, since information is scarce and it costs. But only most recently has this theory moved beyond the question of the role institutions play to begin looking into their dynamics (for instance, see North 1990). Interestingly, in this attempt, the neo-institutional theory has borrowed heavily from evolutionary economics.

The central evolutionary thesis on the dynamics of institutions is that, as a rule, economic – as well as political – institutions come into

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existence, evolve and sometimes undergo a demise through the actions of single individuals. This assumption is thoroughly consistent, of course, with the underlying methodological individualism of the evolutionary approach. While institutions come about because of individuals acting on their initiative, they do not build institutions with well-defined and calculated end-goal or vision of their exact shape. Such complete – and optimal – vision is simply not possible because social institutions are too complex for anybody – even a group – to figure out in all details. Given this general lack of information, the whole process of institution-building proceeds in a largely unpredictable – trial and error – fashion.

For the same reason of complexity, institutions are formed at a relatively slow pace, often unnoticeable to a given generation of individual actors, and they undego transformation in the same slow manner – such changes invariably being complex as well. Altering formal arrangements is less problematic than developing a proper informal setting, in other words, laying down a structure is less complicated than establishing a proper meaning (values, expectations, and habits of those working within a formal system). While the essence of any institutional decay is the breakdown of this informal setting, it is the development of new meaning that is at the very core of any substantive institutional building. The lengthy nature, or slowness of such rebuilding relates mostly to this resistant nature of the informal aspect of any social institution.

It follows from the above characterization that any attempts to radically remake institutions are potentially destabilizing and thus costly to an economy. Such attempts are called in evolutionary economics 'constructivism', or 'radical engineering' as opposed to 'spontaneous' or 'organic' process which we described above. The essence of costructivism is an attempt at wholesale replacement of an established institution with an untested design (= project) preconceived by the state. These are dangerous attempts in part because they assume that no elements of the existing system are usable, even after adaptation – which seems impossible, since, if not useful, they would have been removed, or altered on their own prior to such a state-led institutional overhaul. And when newly introduced elements prove unworkable, it is impossible to correct the errors at low cost by falling back on just removed elements from the preexisting institution.

Since constructivist attempts by the state are highly impractical, they always are executed in a downsized – compromised – version. Deradicalization is typically the first thing that happens to radical systemic

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attempts, and this gives them a chance of temporary survival. Leaving in place certain workable elements from the past helps to stabilize the imposed system before it destroys itself. If the design is well-directed, then, through progressive adaptations, it can evolve into an effective economic system, but even then it won't be totally free of elements existing prior to its imposition. If, however, the project is ill-conceived, then its evolution basically means that various components of the destroyed predecessor system are systematically reinstalled, though it is not possible to recreate the past with any great accuracy. Following the logic of the evolutionary argument, one would have to argue that dismantling such an impractical system should proceed spontaneously rather than through another constructionist attempt.

Growth fatigue

Our application – and test – of the evolutionary model begins with the analysis of the 1971–75 burst of production, unmatched by almost any other East European economy, except possibly Romania, notorious for overstating its own achievements. This upturn was fuelled by a sharp increase in the share of capital outlays in the national product, with a considerable part of this investment increase paid for, however, with a large-scale foreign debt exceeding that of most countries of Eastern Europe. To gain control over the debt, Gierek, in 1976, initiated investment downsizing and wage corrections, but this policy was not able to protect the economy from a production crisis and high inflation. The crisis ravaged the economy from 1979 to 1982, so that by the end of 1982 the national product had fallen to its 1976 level. While many other East European economies registered relative production slowdowns at that time, no other suffered a similar absolute decline – not even the other large-scale borrowers.

Positive growth was resumed by Poland in 1983, but it was an anaemic recovery with little restructuring – a situation which contrasted, for instance, with the other slowly growing economy of Hungary. Investment was not revitalized enough to facilitate stronger growth combined with a fair measure of structural adjustment, nor was the government forceful enough in resetting production priorities. Inflation – after the 1982 price correction – subsided, but shortages were still pervasive, and rationing of many goods was necessary. Trade deficits were turned into surpluses, mostly by keeping imports down, while export revenues remained too low to reverse the increase in the foreign debt. Sooner or later, the economy was certain to show

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the effects of lack of proper adjustment, and indeed, in 1988, major macroeconomic indicators worsened. By 1989, before the economy was able to fully recover from the crisis of 1979–82, another crisis was underway, with industrial output registering a moderate fall.

In 1990, Poland's economy witnessed an even deeper decline in industrial production, which continued in 1991 and then through mid 1992 when the cumulative loss of national product was about one fifth (and industrial output down by almost a quarter). The scale of the 1989–91 economic crisis was comparable in depth to that of 1979–82, though this time it was all of Eastern Europe that suffered a slump as bad, if not worse, than Poland's. Unlike the first crisis, the 1989–91 downturn was accompanied by production restructuring, mostly because of the relatively healthy activity of the private sector. Poland's economy, however, remained deeply imbalanced, so that rates of inflation, after peaking in 1990, fell, although only to high double-digit levels which exceeded those recorded during 1983–87 (though this time, shortages were almost absent as was the phenomenon of so-called shortageflation). External imbalance worsened as well, and the outstanding debt increased, due to further accumulation of all service payments.

At the end of 1991, the combined impact of these two economic crises, separated by a period of elusive recovery, translated into the loss of more than a decade of economic growth. By then, the national product – measured in constant prices – was close to the 1976 level and, if one bases the comparison on per capita indicators, quantitative decline appears yet more drastic. In qualitative terms, this period of, as we call it here, 'growth fatigue', seems to have caused even more economic damage. With relatively limited capital expenditure in the preceding years, production in 1991 was more obsolete than in 1976, when the economy was nearing the end of a several-year investment bulge. Moreover, this economic retardation took place without resolving two serious macroeconomic problems: those of external imbalance and domestic instability.

The economy began recovering from that low point in mid-1992, though initially the growth momentum was rather timid, particularly given the depth of production losses incurred a few years before. At that time, while the state sector continued to be stagnant the private sector showed strong, though uneven, expansion, concentrated mostly in services and to a lesser degree in industry. Investment activities during this early stage of recovery were, at least in light of the official data, very modest. This indicated that substantial restructuring of

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production – other than through trimming the labour force and shifting among exisiting products, including phasing out some of them – was still limited in scale. The level of inflation was further declining, though price increases remained relatively high, suggesting that inflation might be a chronic illness. In part, inflation was fuelled by raising prices of the few remaining state-controlled goods, though a return to budget deficits put additional pressure on prices as well.

Only in 1994, did the economy show visible signs of moving out of the growth fatigue syndrome and assuming a path of self-sustained growth instead – signs which by 1995 were even more evident. At this stage, the recovery was mainly driven by expanding industrial production, in both the public and private sectors. For the first time, investment showed high increases, particularly in the private sphere, where, as in 1995, capital outlays almost doubled making further gains at the expense of the state sector. Helped by recent tax reforms – the simultaneous introduction of income and value-added taxes – budget deficits were prevented from widening, despite increasing budget expenditure (for bank recapitalization, delayed wage increases for public sector employees). The rate of inflation was brought down in 1995 by another few points, even though capital inflows made it more difficult for the government to control the domestic money supply.

Foreign-debt hypothesis

The standard explanation of the 1979–82 crisis and the troubles which followed it is that Gierek, having inherited economic stagnation from his predecessor and afraid of genuine reform, turned to foreign credits. The traditional economic system which under Gomulka produced stagnation by wasting domestic resources was now allowed to waste imported capital. While this capital embodied technology superior to that internally available, any advantage was cancelled out by inefficiency. When debt payments peaked, the industry lacked supplies of goods which it could sell on hard-currency markets. Poland had to default on its debt, which led first to a decline of imports and then to a loss of output. As it borrowed more extensively than the rest of the region, it also suffered a deeper crisis of production.

We find, however, no strong evidence to support an argument that there was massive misuse of imported capital. While Poland, under Gierek, did indeed dramatically increase imports through deficit financing, it also modernized its industry rapidly. This upgrading of

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domestic production was combined with a visible structural shift (e.g., towards durable consumer goods) which further helped to strengthen its competitive standing. Although Poland borrowed more, its economy also made much greater progress in entering these markets and earning higher unit-values than did most of Eastern Europe. Thus, according to our data, Poland seemed prepared in export terms, if not to prevent a crisis, then at least to avoid so deep a fall as in fact occurred.

Problems stemmed not so much from the deficit financing of growth as from the fact that Poland's export capacity was immobilized during the critical period of 1979–81 by massive strikes unknown to most of the other East European economies at that time. At some point involving a majority of the state enterprises, these stoppages drove production below the level to which import decline was dragging the economy on its own. Even industries not particularly dependent on imports, such as mining, experienced large output losses. These reductions in output often hurt exports, mining again being a case in point. In fact, the losses in energy exports – the main source of hard currency – happened to be particularly detrimental, as unearned income from coal sales equalled one fifth of the dollar debt payments due in 1980–81.

We also provide ample statistical evidence that, beginning in 1982, under Jaruzelski, the communist successors to Gierek, the economy again did not fully utilize the export potential created during the period of import-led growth. The debt servicing policy was intended to generate the minimum hard-currency revenues needed to avoid default, rather than maintain, or even upgrade, export potential to arrest the foreign debt. The priority was to supply goods domestically to meet consumer demand, so that exports of products not particularly sensitive to imports often did not show substantial recovery, as was the case with energy and foodstuffs. The shares of many export sales in domestic production, whether dynamic or stagnant, fell significantly, indicating economic inversion – closing – as well.

The export potential was not fully mobilized until 1990 under the impact of reforms introduced by the Mazowiecki cabinet. Even then, however, neither stimulation of exports nor servicing of foreign debt were high among governmental priorities. The government suspended payments with the acceptance of the lenders who, in a sudden change of heart, also agreed to open talks on debt reduction. Exports to hard-currency markets increased sharply, almost by one-fifth, this mostly in response to the domestic crisis that caused a sharp fall in domestic

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demand. Many producers also tried to redirect their trade to these markets from the rapidly shrinking regional trade centred on the Soviet economy. That the national economy was able to mount such an export surge – and relocation – spoke not only to the adaptability of state enterprises which dominated exports, but to the availability of saleable outputs as well.

The 1990 export surge subsided in 1991, and only in 1994 did the economy again engage in a rapid expansion of exports, to report another record in 1995, when foreign sales rose by more than a quarter. While in 1990–91, exports cushioned the recession, this time they seemed to be the primary driving force behind production growth. Since exports far outpaced production, the economy was able to mobilize for foreign trade more effectively than under the threat of recession, this causing a rise in currency reserves, which reached one third of annual import expenditures. A sizable debt reduction – through a Brady-type facility – made Poland's financial situation even more comfortable, and with this its credibility was regained (as reflected in the first placement of government bonds on the international market). Thus, moving out of the growth fatigue has paralleled an end to unmanageable payment problems, though the final test is still to come when larger payments are resumed after 1997.

Domestic Imbalances

Rather than seeking the economic roots of unmanageable debt solely in the wasteful importation of capital, this book stresses the distractive role of domestic imbalances. These imbalances had already emerged at the beginning of Gierek's tenure, when real wages were allowed to outstrip yearly productivity increases, causing diversion of exportables to the domestic market. The 1976 'economic manœuvre' reduced the pace of real wages, but increasingly stiffer anti-wage measures were clearly needed to fully mobilize exports. When tried in 1979, such an austerity policy provoked mass-scale strikes, which culminated first in 1980, and then again in 1981, all of this causing real wages to further outpace labour productivity than before the 'manœuvre,' so that conditions for debt stabilization worsened.

The price and wage operation executed by Jaruzelski under the shield of the 1981 martial law, helped to create domestic conditions more favourable for debt repayment. A substantial decline in real consumption allowed the economy in 1982 to produce its first trade surplus in many years – a situation which continued through 1987.

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Remaining pressures on wages forced the regime, however, to rely more heavily on cuts in domestic investment than on trimming consumption. With reduced capital outlays often insufficient for replacement of retired equipment, the export capacities created under Gierek were soon allowed to deteriorate. Consequently, while experiencing short-term improvement in foreign debt servicing, the economy was less and less prepared to cope with the long term payments on its persistently increasing debts.

The period of relatively reduced domestic imbalance – and certain progress in debt stabilization – came to an end in 1988, when workers won some major wage concessions, among them a remuneration parity for industrial workers, civil servants, and farmers. Provoked by the price reforms of Messner's cabinet, the gains made by workers pushed wages far ahead of inflation, aggravating domestic shortages. The next wave of real wage increases came in early 1989, when the free unions concluded their roundtable talks with the communist party (e.g., generous indexation of nominal wages on a monthly basis). Expectedly, this relaxation of income policy was followed by drastic deterioration in the foreign trade balance (and in an alarming increase in the current account deficit).

The 1990 reforms helped to restrict real wages through regressive indexation, which only partially covered the effects of price increases in that year. This reduction in real wages – by about a quarter – marked a sharp turn in a lengthy trend, particularly given the fact that real wages were not allowed to increase by any significant measure until 1994 (though they gained in dollar terms – not an insignificant fact given the increasing trade opening and thus greater reliance on imports). That such wage losses were tolerated by the workers whose unions brought the Mazowiecki government to power might seem odd. But the unions were not indifferent or unaware, rather, it had taken them a long time to gain any major concessions, such as the removal of crude wage limits, because with great uncertainty over the future of their enterprises and stiff competition from the rapidly expanding pool of unemployed, workers were reluctant to take on any more radical measures.

To the critics of the 1990 reform programme, the wage reduction was simply too severe, since bringing inflation down could have been accomplished with less wage reduction, particularly if more prices were left under state control for a while. By releasing most of the remaining state-fixed prices in 1990, inflation was temporarily accelerated, thereby wiping out household savings. This only added unneces-

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sarily to the decline in domestic demand and made the production contraction far worse. There is no doubt, however, that this reduction in real wages and their relative stability since greatly helped to energize exports (other positive factors being the temporary undervaluation, or greater flexibility allowed in spending foreign currency revenues). This becomes particularly obvious if one considers the fact that real wages have been relatively stable despite steady increases in labor productivity since 1992.

System reformability

Linking debt problems with domestic imbalances offers only a partial explanation, for the question arises as to why such imbalances occur in the first place. Given the critical role of systemic factors in determining the state's ability to control wages and prices, one might first consider an institutional explanation. But here we are confronted with the enigma of imbalances happening in a central planning system that was originally well equipped (better than the market system) to prevent instability (see Portes 1983). There is little doubt that prior to Gierek's leadership, this systemic design proved quite effective in holding real wages under strict control and restricting price increases. It could be, for instance, that – as the totalitarian school suggests – the system did not change but that the economy did, meaning that one and the same system, though effective at the early stage when the economy was relatively simple, became ineffective as the economy grew more complex.

Of course, this argument on systemic fixity (= rigidity) could be used for explaining issues besides the foreign debt. Presumably, leaving the economic system unchanged would not only undermine the state's control of wages and prices, but would actually make other aspects of economic life less governable as well. Following this line of reasoning, one could then argue that such a deterioration of efficiency by a frozen economic system could lead not only to domestic imbalances that made arresting the foreign debt crisis impossible but it could also cause the overall decline in growth momentum that coincided with the crisis in external debt servicing. Using our terminology, we would then have to say, or hypothesize, that the claimed lack of any substantive adjustments in the traditional economic systemic could possibly be seen as a key factor responsible for the occurrence of the growth fatigue.

But our analysis of the post-1970 evolution of the system's property

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structure and coordination procedures suggests that, quite to the contrary, the communist economic structure was dynamic in the evolutionary sense. It passed through its first important transformation under Gierek's regime, when an attempt was made to reform the middle level of the economic structure. It was then that the real locus of control over resources shifted from the narrow centre – under party supervision – to industrial ministries and associations. Simultaneously, the discretionary power of regional authorities over resource allocation was increased. Since this delegation of decisionmaking did not empower enterprises or localities, contemporary critics have argued that Gierek's reforms were meaningless. We claim, however, that this was a significant change in the property regime, as it involved a power transfer from a relatively unified centre to a number of generally disjointed, self-centred industrial lobbies.

The next major change in institutional structure (= order) came under Jaruzelski, in 1982, when he introduced a package of legal measures largely patterned after the 1968 Hungarian model, which is known as the 'new economic mechanism.' This reform, received with great scepticism by the opposition as another empty gesture, was critical, as it shifted the locus of power from industrial lobbies to worker collectives. Workers – acting through councils and general assemblies – became the dominant stakeholders and supervisors of enterprises. For all practical purposes, Poland's economic system assumed the shape of labour-management, representing, of course, a fundamental departure from the original Hungarian model, which gave the major say at the enterprise level to managers (a situation not altered even by the 1984 rules giving more control to the workers, since they did not make use of these rules).

Beginning with the policies of the last communist leader, prime minister Rakowski, the economic system entered into yet another major phase in institutional transformation. Critical here was a series of decisions by Rakowski in 1988 to allow privatization of public capital assets by state-enterprise managers and party apparatchiks, a form of so-called political capitalism (or corrupt market where public positions within power structure are used to acquire advantage in amassing capital for private uses). This phase represented the logical next step in a long process in which private activities were allowed to expand (including through leasing state capital and licensing of certain imports to private parties from within the political elite).

The wave of reforms executed by Rakowski's cabinet was followed by Mazowiecki's programme which envisioned even broader – and

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bolder – systemic changes in what was offically termed the transition to capitalism. An argument is often made by the authors of that reform package that in contrast with their stabilization measures, the systemic component – including asset privatization – mostly failed to materialize. It is true that this ambitious programme called for converting most of the state-owned enterprises into private entities within three to four years and that very few conversions took place during that period. This apparent slowness in privatization is then blamed for the 1990–91 production losses, which came as a major surprise to the reform team, for they expected only a short-lived production loss that would be more than eliminated within the first year (for instance, see Sachs 1993).

But the way we see it, the economic system under Mazowiecki's government underwent quite radical changes, including the status of the ownership structure. While it is not debatable that only a few assets were privatized in the sense of full title transfer – except for services – this does not mean that the announced intention to privatize had no impact. When assets are said to be put up for sale at some, even not precisely specified, point in time, this by itself affects the status of property rights. And in this narrow, though not practically insignificant sense, the reform steps taken by Mazowiecki's team were truly radical. One should also keep in mind that systemic reforms were not limited to reconfiguration of property rights but involved coordination procedures too. By almost full elimination of the remaining directives for state enterprises and suspension of the majority of subsidies, the government did nothing less than to radically alter the coordination mechanism in this sector, and, given its dominant weight, in the whole economy as well.

Political dynamic

Not only have reforms in the economic system during the communist rule proved possible, but so have reforms in the one-party political system, this providing an even more formidable challenge to the totalitarian argument on nonreformability (which claims that even if the communist party would reluctantly permit economic reforms, they would serve as a substitute for political change). As we demonstrate, reforms were taking place in both of these elements of the overall social system of communism, and, importantly, in relative synchronicity, or, as we would prefer to call it – in a coevolutionary way, as was the case, for instance, during the Gierek period, marked by a consider-

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able increase in intra-party disunity. It was this inner disunity which facilitated the formation of powerful special interests, as well as of well-organized labour. The latter further benefited from the fact that Gierek, unlike his predecessor Gomulka, was ready to accommodate extra-party political forces. The reality of power rather than the ideal of communism was what mainly concerned the Gierek regime – with the power not exercised unilaterally but instead 'contracted' out with the workers.

Nor did the post-1981 period lack political reform, though the trend is not easy to follow. An intriguing aspect of martial law was that, rather than restoring the party to its previous standing, it only assured its survival in the face of increasingly militant unionism. The 'state of war' provided a mechanism for Jaruzelski to shift the power base to the state apparatus, i.e., from the cadres to the bureaucrats. Moreover, rather than remove the oppositionists, military rulers ended up only restricting their space, with the intention of bringing them into formal political channels through selective inclusion. The parallel depoliticization of the party and 'politicization' of the opposition – with the state as a mediating force – was intended to create conditions for finding a lasting solution to the all too obvious political crisis.

As a logical outcome of years of inclusion policy, Poland, before any other communist country, in 1989, entered into power-sharing negotiations between the communist party and anti-communist forces. Early that year, a group of mainly military and police officials – supervised by Jaruzelski – brokered a compromise between the two political forces. This peaceful retreat by the communist party – under pressure from the opposition – opened the door for further major political changes. The two sides agreed to semi-free elections and a number of other arrangements (often seen as temporary) to allow for the orderly redistribution of power. This political experiment proved successful, for, though the communist party lost the elections, the power locus was indeed transferred in an orderly fashion.

While the mid-1989 removal of the communist party from centre stage greatly helped accelerate change, the public at large has continued to be politically withdrawn and suspicious of politicians – whom they judged mostly by moral criteria. Nor has the style of political discourse radically changed, with a number of the old symbols still visible. After adopting a socialist stance, the former communist party gathered one of the largest single blocs of seats in the 1991 elections, and went into the late 1993 race as the sure winner. The once reformed communist unions – a product of the 1981 state of war –

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have emerged as possibly the strongest single representative of labour. With their backing, reformed communists, in alliance with a less numerous but very well-organized peasant party – also with communist period roots – formed a government led by Pawlak.

The regaining of political control by the communist-period official parties is particularly instructive, since similar 'returns to the present' (rather than to 'history', i.e., pre-communist politics, dominated by conservative forces) have taken place in many other post-communist states. In Russia, the communist party was forced out of formal existence by a decree in 1991, but it soon came back to retain control over parliament despite formidable obstacles (forceful dissolution of communist-dominated parliament, near-exclusion form the media, to name a few). In Hungary, where the communists had left a power monopoly through negotiated settlement, the 1994 return of their successors, engineered through local level vote getting, was decisive too. (Seeing this continuity throughout the region, one is better prepared to appreciate the pace of political change under communism.)

Paradoxically, in certain cases, it has been the rules established during – or right after – the negotiated transfer of power by respective communist parties that have prevented ex-communist political formations from exerting more political influence. In the case of Poland, such an obstacle has turned out to be the division of powers that gave great prerogatives to the presidency office (originally meant to secure a power share for the communist elite even if they were to lose the first open elections). The office – under Walesa – has been the single most formidable obstacle faced by the coalition, despite the very low popularity of the president himself. In Russia, to give another example, despite their control of the parliament, the ex-communist forces have had limited influence on governing, for the executive branch has been controlled by the new highly independent office of the president (which, under Yeltsin ironically, recreated the old Politburo structure).

'Real' interests

The fact that the original centrally planned system went through many intermediate forms following a rather clear pattern, would suggest that some groups or individuals could have had a hand in it for a considerable period of time. Since so much change has taken place, both within economic and political realms, this would contradict the conventional view, expressed in the past, that under the political rule

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of communism, there was nobody who could benefit from substantive economic reform or political change. In this static view – which can be linked to the totalitarian paradigm – party leaders were said to be most content with their power monopoly, enterprise manages with the automatic bail-outs, while the workers are seen as fully pleased with their low-pressure and secure jobs in state-owned enterprises. Similarly questionable in this light is the frequently made claim that the state, driven by theoretical interests, was solely responsible for advancing market reforms in the post-communist period, because there were no other groups who had an advantage and/or 'real' interest in rebuilding a capitalist economy (see Staniszkis 1991; for critical analysis, see Poznanski 1995d).

However, as is shown, 'real' interests can be found though at the individual – not collective – level, and not in one specific segment of society but rather throughout it. This includes the communist party, which was as much weakened by the internal disintegration caused by actions of its members as by openly hostile attacks from the political opposition. The party lost its cohesiveness in large measure because its members began putting their personal welfare ahead of the advantages of a collective hold on power. While individual actions were initially not intended to undermine the party, they ultimately had this effect and during the final stages of communism, under the pressure of a self-interested membership, growing segments of the cadres consciously engineered their party's demise.

Many in the state apparatus, including managers, contributed to the undermining of the traditional system, for much the same reasons that caused corrosion of the party. While the rigid central planning system offered job and wage security, state officials, as utility maximizers, were increasingly ready to trade these economic advantages for opportunities to better themselves financially as individuals. A rapidly growing illegal sphere – state corruption – was less a reflection of increased moral decay than of unchecked natural instincts to improve one's own wellbeing. Less and less manageable by the party, state officials found themselves in growing conflict with the cadres, as each group tried to obtain the best access to limited resources – power and wealth. Given the strategic location of the state apparatus in the political structure, their actions had to have great consequence.

The 'individualization' of the party membership and growing lack of discipline within the state apparatus were not the only factors that contributed to the expansion of the private domain or civil society.

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