Winiecki, Jan

Working Paper

The Polish transition programme at mid-1991: Stabilisation under threat

Kieler Diskussionsbeiträge, No. 174

KIELER DISKUSSIONSBEITRÄGE

KIEL DISCUSSION PAPERS

174

The Polish Transition Programme at Mid-1991: Stabilisation under Threat

by Jan Winiecki

CONTENTS

- Monetary restraint in Poland does not operate in the expected manner under the conditions of predominant state ownership of both banks and industrial enterprises.
- With effective owners' control being prohibitively costly in the state-owned firms, "nobody's" banks continue their old lending pattern to large state-owned enterprises regardless of the latters' creditworthiness and profitability. "Nobody's" enterprises accustomed to soft budget constraint are not deterred by high interest rate levels.
- Under these circumstances macroeconomic restraint does not select the best enterprises but in fact does the reverse: Least efficient large enterprises survive, while smaller but more efficient ones starved of credits are threatened with bankruptcy.
- Inability to cope effectively with the legacy of the Soviet-type economy is compounded by autonomous policy errors. Apart from too nervous reactions to monthly changes in the inflation rate, the major mistake has been the timing and scale of tightening monetary policy. The sharp increases in the interest rate were effected almost weeks before the major demand reduction for Polish products resulting from the expected changes in trade with the Soviet Union. As a result the economy received a strong recessionary blow from monetary policy that preceded another major blow from the fall in foreign demand. Inevitably the economy went into a recession that did not end by June 1991 while inflation continued.

INSTITUT FÜR WELTWIRTSCHAFT KIEL · SEPTEMBER 1991

ISSN 0455-0420

Contents

Deutsche Bibliothek - Cataloguing-in-Publication Data

Winiecki, Jan:
The Polish Transition Programme at Mid - 1991 :
Stabilisation under Threat / by Jan Winiecki. Institut
für Weltwirtschaft, Kiel. - Kiel: Inst. für Weltwirtschaft,
1991
(Kiel discussion papers; 174)
ISBN 3-89456-013-4
NE: Kieler Diskussionsbeiträge

ISSN 0455 - 0420

I. Introduction

When the present writer assessed the Polish transition programme at mid-1990 [see Winiecki, 1990a], the assessment was on balance highly positive with respect to stabilisation. Near-hyperinflation disappeared (and this happened in spite of far-reaching price liberalisation), the large budget deficit disappeared as well, and there was a fast growing surplus in foreign trade. The price paid for this was a sharp fall in output and rising unemployment, although at a much slower rate.

I pointed out, however, that a large part of that output was in fact system-specific waste that disappeared at the early stage of the transition to a market economy. Its disappearance signified in reality the decline in the use of inputs per unit of output, i.e. economic gain trough higher efficiency, rather than economic loss [see Winiecki, 1990a; 1990b; 1991d]. Thus, real costs were lower than statistical ones.

Now, a year later, the transition, and even its stabilisation part, is assessed in strikingly different terms. At the one end of the spectrum, especially within the country, it is seen as an unmitigated disaster; at the other end, optimists, who are few and far between, see nothing wrong with the stabilisation programme as such and ascribe mounting problems only to the deterioration in external environment. This is the view of the Polish government's macroeconomic team, of international institutions and some Western experts and journalists (apart from government's pronouncements; see, for example, a report from the meeting with a high-ranking IMF official, Mr. Richard Erb, Zycie Gospodarcze, 1991, No. 20, or Gomulka [1991], or Martin Wolf in Financial Times, May 3, 1991, or Business Week's special report, April 11, 1991).

This author is situated somewhere in the middle. He regards the stabilisation programme as by and large sound in its principles but on the verge of an extremely costly failure. This looming failure is the product of accumulating effects of policy errors and transplantation of policy instruments without regard for the different institutional environment of the post-Soviet-type economy (post-STE) in which these instruments operate. Applications of these policy instruments often bring about perverse effects. As things get worse rather than better, the whole programme comes under threat.

II. Mid-1990 to Mid-1991: On a Keynesian Roller-Coaster

The basically positive assessment at mid-1990 could not, or at the very least **should not**, put aside some worrying and/or puzzling aspects of the situation. First, inflation did not disappear but, since March 1990, stabilised within a 3-5 per cent per month range. This in itself was not unusual: post-hyperinflation recovery has often been accompanied by "inertial" inflation [see, e.g., Dornbusch et al., 1990; Bernholz, 1990]. However, over the next year it did not decline. In the second quarter of 1991 it was about the same as it had been in the second quarter of 1990.

More worryingly, inflation continued in spite of the surprisingly large budget surplus in mid-1990, as well as the steep fall in real wages. The traditional inflation-boosting phenomena were, thus, absent in the Polish economy at mid-1990. Next, output recovery was not forthcoming and this was definitely more puzzling. Although part of the output fall could be seen as an adjustment to a more efficient economic system, the recovery was barely noticeable in the second quarter of 1990. Furthermore, nobody expected a fall of such magnitude (whether adjustment to a more efficient system was taken into account or not).

Last but not least, a steep fall in real wages (even if overstated by statistics) should have been expected to give rise to wage claims aimed at recovering a part of the lost purchasing power. Wage controls implied that these claims would politicise the wage conflict since they shifted claims from enterprise to government level.

Under such circumstances some macroeconomic policy change had to be expected, accompanied by other measures correcting effects of the legacy of Soviet-type economy (STE) on the transition process. The latter measures were all the more necessary as state-owned enterprises (SOEs) were not adjusting to new conditions as rapidly as expected. In some respects adjustment was not only slow but also perverse. This happened in spite of the perceived restrictive macroeconomic policy framework - this was at least a near-consensus view [see, however, Winiecki, 1990a].

Not unexpectedly then, the summer of 1990 brought about some macroeconomic policy change. The central bank (NBP) reduced further the interest rate (and shifted it from a monthly to an annual basis) to 34 per cent per annum for refinancing loans for commercial banks (the central bank's basic lending rate). This amounted to a decrease from 4 to 2.5 per cent on a monthly basis, probably too large a decrease considering the monthly inflation rate in the second quarter.

Fiscal policy was slightly less restrictive but in a wrong way. Deferments of tax payment were accepted when applied for. "Reinterpretation" of application of indexation rules created greater room for wage increases, too. However, an alternative of gradual reduction of budget surplus and elimination of wage controls were, in my opinion, a sounder way of reducing a degree of macroeconomic restraint.

The foregoing had some macroeconomic effects. Industrial output that stagnated from March till May picked up already in June (4.9 per cent on a month-to-month basis) and continued by and large uninterruptedly till September 1990 at a rather elevated pace, a 12.2 per cent dip in the vacation month of July notwithstanding. However, output was again flat in October. The price pattern did not change, though. Inflation continued within a 3-5 per cent per month range. The best month was certainly August 1990, when industrial output grew by 7.6 per cent over the preceding month (although after the traditional July output dip), while the consumer price index (CPI) increased by 1.8 per cent only. The inflation abatement turned out to be one month's departure from the range observed since March, though, and the CPI growth rate moved back to its earlier range (4.6 per cent in September).

This obviously unnerved the macroeconomic team of the government and influenced the decision of the central bank. The central bank increased its basic lending rate from 34 to 43 per cent on an annual basis in October (3 per cent per month), which might have been closer to the needed one in the face of continuing inflation at the 3-5 per cent month rate. But the October inflation rate did not show any decline and the central bank raised its basic rate again in November to 55 per cent (3.7 per cent per month). This overhasty, nervous reaction to monthly changes in basic indicators that might have been influenced by random or seasonal phenomena had momentous consequences. Since October 1990 the output rate has been strongly under the influence of the rising cost of money. Output and inflation data are shown in Table 1.

It is, of course, possible that the government had hoped for a continuing - quarter by quarter - decline in inflation and took the August CPI growth rate as supporting its expectations and the September price jump not as a return to an underlying inflation rate but as a signal of renewed inflationary pressures. Policy-makers acted, however, without much reflection on the real meaning of a one-month dip in the inflation rate, which did not justify so far-reaching conclusions. (Actually, they acted also without much regard for the easily predictable consequences of deteriorating external environment for the Polish economy and the

Table 1 - Changes in Industrial Output and the Consumer Price Index (CPI), July 1990-June 1991(a)

	Output	CPI
July 1990	87.8	103.6
August 1990	107.6	101.8
September 1990	108.0	104.6
October 1990	100.4	105.7
November 1990	100.0	104.9
December 1990	103.2	105.9
January 1991	82.4	112.7
February 1991	100.8	106.7
March 1991	100.1	104.5
April 1991	91.7	102.7
May 1991	98.3	102.7
June 1991	100.8	104.9

(a) On a monthly basis: preceding month equal 100.

Source: Biuletyn Statystyczny GUS (monthly); Informacja o Sytuacji Spoleczno-Gospodarczej Kraju, GUS (monthly); Informacja o Sytuacji Gospodarczej, CUP (monthly & quarterly).

interaction of sharp interest rate increases with these consequences; see Section IV on "autonomous" policy errors).

Besides, all these policy measures were taken in the overheated atmosphere of forthcoming presidential elections. Both earlier loosening and later tightening of macroeconomic policy were surrounded by an almost surrealist rhetoric. Government tried to present itself as a model of monetary and fiscal rectitude and declared its adherence to macroeconomic restraint in blatant contrast with the actual policy stance in the July-September 1990 period.

Monetary policy was loosened in summer and then tightened sharply in October and November. Fiscal policy, in turn, continued its restrictive stance for most of the year and only in the last month the government tried feverishly to reduce the budget surplus (quite probably fuelling inflation in this way, as the speed of change is an important factor in creating inflationary pressure). Changes in the budgetary balance are shown in Table 2. All these shifts have been accompanied by firm declarations of an unchanged macroeconomic policy course. It is not clear whether such stance benefited the then prime minister who competed for the Polish presidency with Lech Walesa.

The inflation rate continued to be within a 3-5 per cent per month range throughout the rest of 1990 (see Table 1) and this was seen as a revival of in-

Table 2 - State Budget Balance (a), January 1990-June 1991 (cumulative, in billion zlotys)

	Budget balance		Budget balance
January 1990	0.9	October 1990	9.9
February 1990	1.6	November 1990	8.8
March 1990	1.8	December 1990	2.4
April 1990	5.1	January 1991	0.9
May 1990	7.2	February 1991	-0.7
June 1990	6.5	March 1991	-6.2
July 1990	8.4	April 1991	-9.8
August 1990	9.2	May 1991	-9.6(b)
September 1990	8.7	June 1991	8.9

Note: Minus sign means deficit.

(a) State budget, including budgets of local administrations. - (b) Postponed expenditures and unpaid bills amounted in May to approximately 30 billion zlotys.

Source: See Table 1.

flationary pressures although there was no difference between the second and fourth quarter and very little difference between the third and fourth quarter (whatever difference there was, it stemmed from a one-month dip in the inflation rate in August). Nonetheless, the macroeconomic team took all this very seriously and designed for 1991 the policy package that was far more restrictive than envisaged a few months earlier.

Apart from a sharply higher interest rate (to be raised still further in January), the package attempted to reduce the level of budgetary expenditures in real terms in 1991 and tightened wage controls. It is not certain what was the role envisaged in this package for the exchange rate. Fixed in January 1990 - originally for three months - it continued to be fixed vis-à-vis the US$ throughout the year and policy-makers showed no intention to change it in any way. Whether it was seen as an instrument of pressure on SOEs to adjust under competitive pressure from abroad or as part of the anti-inflationary package for 1991 is a mystery for the present writer. Whatever the intention, effects were perverse rather than the expected ones.

Another mystery for the present writer are the government's growth projections for 1991 prepared at about the same time (autumn 1990). GDP growth of 4 per cent per annum in 1991 was under the circumstances completely unrealistic. Growing demand for goods and services has to come from somewhere. However, no demand component looked promising for 1991, given the prepared policy package and - let us add - the external environment for the Polish economy.

Private consumption was to remain restrained since government planned more restrictive wage controls for the state sector (still more than 3/4 of employment). The abolition of wage controls in the private sector was of limited help in this respect. Public consumption was not expected to give additional stimulus as an attempt was made to reduce the level of budget expenditures in real terms. Investment was not very likely to give much boost to economic growth either, after the sharp rise in the interest rate. Interestingly, government projected a 20 per cent growth of investments in real terms for 1991.

Last but certainly not least, foreign demand did not look promising at all. The sharp rise in oil prices accentuated the cyclical slowdown in the West, reducing export prospects in this direction. The loss of Iraqi and Kuwaiti markets also mattered. Worst of all, the change to convertible currency trade with the USSR and other ex-COMECON countries was widely expected to lead to a steep fall in exports (many expected eastbound exports to be cut by half).

On top of exogenous factors reducing demand for Polish exports, the exchange rate policy of the central bank weakened these prospects even further as the exchange rate was maintained throughout 1990 in the face of a CPI increase of 249.3 per cent (and a quasi-WPI increase of 191.5 per cent on a December 1989-December 1990 basis). Although the devaluation at the end of December 1989 was substantial enough to compensate for the expected price increase after liberalisation in January 1990, it has not been sufficient to compensate the 60 per cent loss of purchasing power of the US$ vis-à-vis the zloty by the end of 1990.

At this point there were **no** components of final demand that warranted the optimism displayed by the government's macroeconomic team. Even the expected buoyancy of the private sector was under threat of being throttled by very high interest rates. The optimism of the team went beyond the growth projections and extended to the composition of the budget based often on unrealistic expectations with respect to budgetary receipts.

Reality usually differs from carefully (and even more from carelessly) designed programmes and this has been the case also this time. The election of Walesa to the presidency resulted in a government shake-up. The macroeconomic team, however, remained in place in order to signal foreign creditors and international institutions the willingness of the new government to continue the transition programme with all its fundamental features. Nonetheless, some corrections had to be made to fulfil at least some of the promises made during the presidential campaign.

Budget expenditures increased and so did receipts (albeit to a much lesser extent). A small deficit was projected but even this did not satisfy various government critics. As a result, the budget was not formally accepted by parliament well into 1991. Given the government's optimism with respect to receipts, a substantially larger deficit might have been expected.

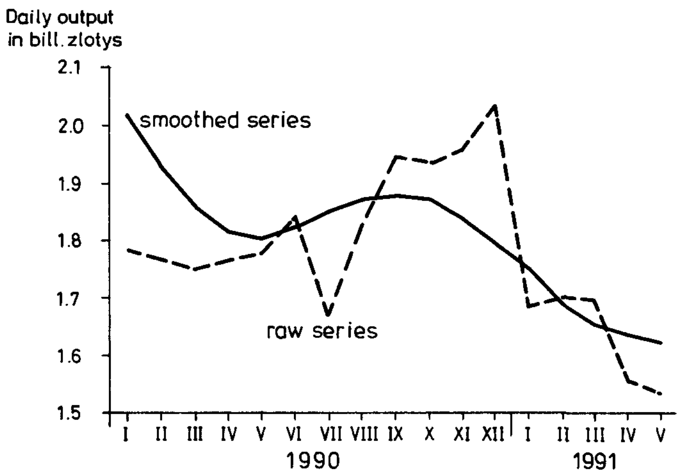
Expansion of budget expenditures apart, all other demand components suggested stagnation if not actual contraction of output in 1991.[1] Industrial output stagnated after October 1990 (a small growth in December, a month usually characterised by much larger output increases everywhere, does not contradict this view) and then slid precipitously by 17.6 per cent in January 1991 with further declines in the March-May period.

Thus, Poland became the only one among post-STEs that underwent a second (in the author's view policy-induced) recession. The shape of the output curve in Figure 1 shows that clearly enough. In Hungary and Czechoslovakia the primary, corrective recession continued for the third and second year respectively, as these countries opted for a less drastic stabilisation package. In Poland the primary corrective recession that was expected to change the demand/ supply relationship and wring out hyperinflation was sharper but ended earlier. Output started inching upward from June 1990. It stagnated, however, toward the end of 1990 and began declining again from January 1991 under the impact of a sharp increase in the central bank's basic lending rate (increased again in January 1991 to 72 per cent on annual and 4.6 per cent on a monthly basis) combined with bank-by-bank credit rationing. Thus, the seeds of recession were visible already in the autumn of 1990 **before** the impact of the drastic fall in exports to the USSR and other ex-COMECON countries began to be felt. It is for that reason that the author calls the recession policy-induced. Within the framework of this policy the May 1991 moderate correction of the interest rate and the exchange rate were seen by many as too little too late.

At mid-1991 the picture is not very encouraging. The recession has not yet bottomed out. Inflation continues within a 3-5 per cent range, with outliers scattered here and there (in 1991 the highest in January due to large increases in

[1] This is, nota bene, what the present writer warned about in a letter to the presidential chancery in December 1990, later circulated privately in mimeo form [Winiecki, 1990c]. Macroeconomic developments in the first half of 1991 proved me right.

Figure 1 - Industrial Output: Raw and Smoothed Time Series for January 1990-May 1991 (in real prices)



Source: Informacja o sytuacji gospodarczej, CUP, June 1991, mimeo.

regulated energy prices and lowest in April). The foregoing suggests the existence of the underlying inflation rate almost independent of the level of the interest rate and the exchange rate, that is of the cost of money and of competitive pressures. Attempts to throttle this type of inflation through orthodox monetary and other macroeconomic measures were evidently unsuccessful.

This suggests that other measures are also needed to achieve this end. Nonetheless the idea remained foreign to the government's macroeconomic team. Supported by other, mostly foreign experts, who did not have any earlier experience with the STE and its possible impact upon transition, they persisted in the conviction of being right on course. However, perverse effects of such policies were clear to some other members of the government. For example the Minister for Industry stressed that the best enterprises are on the verge of bankruptcy, while the worst ones survive without much effort [Zycie Gospodarcze, 1991, No. 18].

Until the end of the period under consideration there were no bankruptcies, although already by the end of January 1991 more than 500 SOEs lost creditworthiness (their number almost doubled since then). However, no bank-initiated bankruptcy proceedings against SOEs to collect the debt have taken place. Nor were they initiated by one SOE against another. Quite obviously, the microeconomic sphere of state-owned banks and state-owned industrial enterprises has behaved differently than expected. Worth noticing has also been the fact that among SOEs which lost their creditworthiness, there were no large enterprises. Since the latter have historically been least efficient under the STE system, the foregoing phenomenon suggested that other forces were at work than the selection mechanism of macroeconomic restraint assumed to eliminate least efficient producers.

Thus, relatively better (rather than worse) SOEs came increasingly under the threat of bankruptcy. In a parallel development SOEs have been increasingly in arrears with respect to taxes. By the end of April 1991 already 2700 SOEs owed 9.8 billion zlotys in unpaid taxes, i.e. more by a third than the size of the budget deficit at that time. Again, arrears did not decline since April. Thus, yet another success of mid-1990 came under threat, i.e. a balanced budget (in mid-May 1991 the Central Planning Board did not rule out the possibility that the budget deficit would reach 26 billion zlotys, that is 3-4 per cent of the projected GDP [Gazeta Bankowa, 1991, No. 21]. Little was left of the highly positive tone of the mid-1990 assessment. A question that needs answering is: **What went wrong?**

III. Microeconomic Foundations of Macroeconomic Failure

The failure has its roots in the interaction between microeconomic and macroeconomic spheres whose outcomes belie expectations of policy-makers (and their advisers) about the behaviour of economic agents under policies pursued through orthodox "Keynesian" measures: manipulation of the interest rate, taxes and budget, while maintaining a fixed exchange rate and, additionally, stiff wage controls.

In an atypical world of post-STEs such as Poland, these measures do not necessarily yield results expected under the market system with a dominant private ownership. In this respect, post-STEs with their near exclusive non-private ownership - especially among larger firms - differ not only from well-functioning market economies of the West but also from distorted market economies of Asia or Latin America [see Winiecki, 1991b].

1. Macro-to-Micro: Too Weak Pressure on SOEs to Adjust throughout 1990

Private enterprises facing falling demand generally try to cut costs, launch new products, seek new channels of distribution, new markets, etc. SOEs in a post-STE such as Poland have, however, property rights assigned in a way that increases enormously transaction costs, as there is almost no owners' control over the management. Therefore, adjustment to falling demand may be different there.

There has been an almost uniform opinion that SOEs did not adjust rapidly enough and, moreover, in some respects their adjustment has been perverse. Although **some** adjustment did take place (reduction of inventories, search for alternative distribution channels domestically and, significantly, shift of a larger share of output to foreign markets), passive adjustment through reduction in output combined with furloughing (more rarely laying off) the labour force has been dominant. Attempts at raising prices were also more numerous than those aimed at cost cutting.

However, an important issue has not really been explored, namely to what extent SOEs were **forced** to adjust. The present writer already stressed the point earlier [Winiecki, 1990a], insisting that SOEs were not strongly pressured in the first half of 1990, i.e. the period that due to both high nominal (and later also real) interest rates and deep cuts in subsidies has been widely regarded as one of severe restriction. He pointed out that although households were severely squeezed, SOEs - in contrast - were not. Fast growth of SOEs' deposits in real terms suggests a relatively good and improving liquidity position throughout the period (Table 3).

Table 3 - Households' and SOEs' Deposits in National Currency, July 1990-June 1991 (in nominal and real terms)

	Households' deposits			SOEs' deposits		
	in billion zlotys	nominal change	real change(a)	in billion zlotys	nominal change	real change(b)
		December 1989=100			December 1989=100	
July 1990	52.3	299	107(c)	38.9	442	179
August 1990	56.6	323	113	46.3	526	204
September 1990	61.9	354	119	48.5	551	187
October 1990	66.2	378	120	51.6	586	190
November 1990	71.0	406	123	54.5	637	200
December 1990	77.5	443	127	51.8	589	178
January 1991	76.5	437	111	55.4	629	174
February 1991	87.4	499	119	54.0	614	157
March 1991	96.4	551	126	55.8	634	164
April 1991	106.4	608	134	60.5	687	176
May 1991	110.6	632	136	61.6	700	176

(a) Deflated by CPI. - (b) Deflated by quasi-WPI. - (c) First month in which households' deposits exceeded the already very low December 1989 level.

Source: See Table 1.

This good position did not result from credit expansion (credits to domestic economic agents fell between December 1989 and June 1990 by some 20 per cent in real terms). But SOEs found other sources of financial support to survive the macroeconomic squeeze. Firstly, their input inventories (generally much larger relative to output than those in Western enterprises) increased still further in 1989 as near-hyperinflation created additional incentives in this respect. In consequence, input inventories in industry increased by 20 per cent (!), with the purchase fuelled by ever cheaper money (as interest rates were not raised to even near real positive levels in the face of fast price increases). The same applied to imported inputs (since the exchange rate was not raised sufficiently to make up for very much faster domestic price increases). Altogether, cheaply bought inputs used in highly priced outputs after the price liberalisation in January 1990 ensured high profitability even at low capacity utilisation rates.

There was yet another source of liquidity, namely the stock of convertible currencies accumulated by enterprises under the export earnings retention scheme. Since the right of enterprises to keep foreign exchange accounts was abolished under the transition programme, SOEs drew this stock down rapidly, reducing it by 60 per cent between December 1989 and June 1990 (i.e. by US$ 1.7 billion). Although the consequences of the foreign exchange regime change in this respect were not difficult to predict, no attempt was made by the government to neutralise at least part of the expected money inflow.

And, lastly, as the shift to exports gathered pace, while imports were trailing behind, the trade surplus became another, more lasting source of liquidity for exporting enterprises. Whatever the sources, monetary constraint on SOEs in the January-June 1990 period has not been as strong as is generally claimed. What is worth stressing here, though, it is the fact that tightening macroeconomic policy required also measures other than interest rate changes (such as neutralisation of domestic currency effects of abolished foreign exchange accounts).

One could have expected that later in the year, as stocks of cheaply bought inputs and accumulated convertible currencies declined markedly, the degree of pressure to adjust would increase. As stressed in the preceding section, however, the interest rate was reduced and credit expansion accelerated in the summer of 1990 (see Table 4). The pressure to adjust decreased in fact. Consequently, macroeconomic policy influenced the microeconomic adjustment of the state enterprise sector the wrong way.

Table 4 - Central Bank's Basic Lending Rate, July 1990-June 1991 (on monthly and annual basis)

	Monthly rate	Annual rate
July 1990	2.8	34
August 1990	2.8	34
September 1990	2.8	34
October 1990	3.6	39
November 1990	4.6	47
December 1990	4.6	55
January 1991	4.6	55
February 1991	6.0	72
March 1991	6.0	72
April 1991	6.0	72
May 1991	4.8	59
June 1991	4.8	59

Source: Biuletyn Statystyczny GUS (monthly); Narodowy Bank Polski: I Kwartal - Ocena Wstepna (quarterly).

2. Micro-to-Micro: Interaction of "Nobody's" Banks and "Nobody's" Industrial Firms

Under normal, "textbook" conditions there is no other way of wringing out inflation from the economy than a gradual or sharp tightening of monetary policy (Keynesians who advise Polish policy-makers add to the above also wage controls). However, under the far from normal conditions of a post-STE, manipulation of the interest rate may be a necessary but not sufficient condition to achieve this goal. What is missing among policy-makers and their advisers is the realisation that state-owned banks and state-owned industrial firms do not behave the way their private counterparts in a market economy do.

Since costs of control are extremely high in the case of an abstract owner, i.e. the state [see, e.g., Furubotn, Pejovich, 1972; Jensen, Meckling, 1976; Demsetz, 1980], state-owned commercial banks do not look at their clients the way privately owned banks do in the West. Historically, they have always been lending first of all to large SOEs and - partly prodded by inertia - they continue to do so under the changed regime.

Banks owned by "nobody" are run by bureaucrats who rarely know what prudent lending policy is about and even if they do they rarely care. The creditworthiness of their clients is not a matter of serious concern to them. Although they compile at the request of the central bank the list of enterprises that lost creditworthiness, they do not draw conclusions from the fact. A study by the central bank [see Informacja NBP, 1991] reveals that by the end of January 1991 there had been no case where a commercial bank initiated bankruptcy proceedings against its debtor. About half of the enterprises concerned were on the list of uncreditworthy ones for about half a year and no bankruptcy took place. Obviously, either these enterprises could do without credit or obtained it regardless of their lack of creditworthiness.

Lending inertia is matched by borrowing inertia. "Nobody's" enterprises are not concerned to the same extent as private enterprises by ballooning debt-to-equity ratio. In fact, a question posed that way would be greeted in many SOEs with incomprehension: they are unaccustomed to think in those terms. As long as there is money to pay wages, things do not look too bad. And many SOEs borrow exactly for that purpose. Trade unions, self-management bodies and employees all are steeped in the past and many still think that somebody owes workers undemanding work pace and low but secure wages. There are no owners ready to intervene, shake up the management and try to save the firm. Nobody speaks in the name of capital. The ghost of bankruptcy is still for most enterprises exactly that - a ghost. When things get really bad and a consensus emerges that something should be done it is usually too late.

Not only inertia carries over old patterns of behaviour but also political economy of transition. Old nomenklatura linkages that generated "soft" budget constraint under the STE regime still exist here and there but, worse still, new political linkages affect monetary policy in the same manner. Linkages between enterprise managers, communist party apparatus and banks or ministries [see e.g. Winiecki, 1989; 1991a] have been largely superseded by those between self-management bodies and "Solidarity" enterprise level union organisations, "Solidarity" regional federations and friendly local officials and parliamentarians who try to influence banks and ministries so that they come to the rescue. Since state banks' managers are still de facto appointed by bureaucrats, not by bank private shareholders, they are sensitive to outside pressure. In this manner "soft" budget constraint has been resurrected in the transition process.

Just as in the not so distant past, there is a very specific pattern of leniency in lending. It is the biggest SOEs, possessing the strongest political clout, that encounter no problems in borrowing. Interestingly, on the list of 523 enterprises that lost their creditworthiness by the end of January 1991 there was no large enterprise. Therefore, although it is nobody's secret that historically they were least efficient among SOEs, they are still regarded as creditworthy.

And in a paradoxical way they are, because they believe that if the worst comes to the worst, the state will bail them out. This assumption was even articulated expressis verbis by a left-leaning "Solidarity" leader, Bujak, who said, while referring to a difficult situation of the large tractor-producing enterprise "Ursus" that it is too big a firm to simply go bankrupt [quoted in Gazeta Wyborcza, February 19, 1991]. Many do not say so but act on the basis of the same premise. No level of interest rate is high enough to deter them from borrowing. The consequences of such a pattern of behaviour of state-owned banks and enterprises are highly damaging in the transition to a market economy.

3. Micro-to-Macro: Perverse Effects of Interest Rate Manipulation under Different Ownership Structure

Since January 1990 monetary policy in Poland has been pursued mainly through the manipulation of the interest rate (plus changes in the reserve ratio and, less fashionably, credit ceilings for individual large, state-owned commercial banks). However, the use of the interest rate is not a very efficient anti-inflationary and, conversely, stimulatory measure, where ownership structure differs radically from that of a capitalist market economy. Five quarters (from the second quarter of 1990 to the second quarter of 1991) of persistent inflation at a basically unchanged monthly rate ranging between 3 and 5 per cent should be regarded as sufficiently convincing in this respect.

In reality, the impact of interest rate manipulation on persistent inflation is not only weak but to a large extent **perverse**, i.e. its outcomes are opposite to those intended by policy-makers. The assumption, e.g. behind restrictive monetary policy, is that the higher cost of money will lead to a positive natural selection of enterprises and projects, with those more profitable expanding or surviving and less profitable ones contracting or exiting from the market. In the light of what I wrote in the preceding sub-section, this assumption is clearly wrong for a post-STE such as Poland. Let us outline the sequence of events under monetary policy applied in a manner described above. In reality, it will be a re-run of Poland's monetary policy between September 1990 and May 1991.

Policy-makers interpret a rise in the monthly inflation rate not as a variation within a range it displayed in the recent past but as an upward shift in the inflation rate. The Keynesian reaction is to raise the interest rate. Impatience, coupled with belief in quick results of such a manipulation, makes them repeat the move again if the inflation rate does not decline almost instantaneously. Thus, in Poland the central bank's basic lending rate was raised twice from 34 to 43 per cent, and later to 54 per cent, - all within a two-months period.

The credit squeeze is beginning to bite. But is it biting whom it should? The answer is - **no**. Inertial lending plus political clout result in a situation where the largest and generally least efficient SOEs will generally obtain the credit volume they ask for anyway. But other, smaller and relatively more efficient SOEs will get **less**. Firstly, they borrow somewhat more prudently and are often deterred by very high interest rates. And, secondly, if there are credit ceilings on a per bank basis, the shrinking credit pie affects them in the first place. Thus, it is the relatively better SOEs that are adversely affected by an interest rate increase. As they face mounting difficulties and sometimes totter on the face of bankruptcy, the output structure gets **worse** rather than better. Private enterprises are also adversely affected. Although a share of credits set aside for the private sector protects them against being crowded out, nothing protects them against the high price they have to pay for borrowed money. Since few projects can be so profitable, output expansion slows down or even declines in the private sector as well. The output structure in the whole economy gets worse still (quite apart from the stagnating output **level**).

But inflation continues within the same range as before (see Table 1). This is not surprising for the present writer. Large SOEs, immune to the threat of bankruptcy, will continue to raise prices. Some of them enjoy a monopolistic position unaffected as yet by external competition, some others are not much afraid of the fall in demand resulting from price increases (after all, the shortfall in the cash flow will be made up by new credits...).

Without more competition, changes in the ownership structure and attempts at hardening "soft" budget constraint, there will be little improvement. But in the Polish case this is not the philosophy of the government's macroeconomic team, its advisers and - let us add - the IMF in the background. The reaction is usually "more of the same". Inflation continues (in Poland increases, as government raised controlled energy prices in January 1991, and policy-makers decided to raise the interest rate again to 72 per cent on an annual basis). The results? Adverse selection of borrowers continues. Output structure gets worse still. Economic activity is even more severely hit. A push turns into a shove. Stagnation turns into decline.

This is the picture of the Polish economy in the September 1990-May 1991 period. The outcome is continuing inflation and a shrinking economy. Within a shrinking economy the output share of the worst performers increases rather than decreases. Results are exactly opposite to those expected under textbook conditions of a different ownership structure.

The question may be raised whether the opposite direction of monetary policy brings about as perverse results as monetary restriction. On theoretical grounds one may expect somewhat less adverse effects. Assuming that the volume of credit for those large SOEs with strong political clout is by and large fixed (in real terms), relaxation of monetary policy is expected to increase the volume of credit for relatively more efficient smaller SOEs and for private firms due to lower interest rates and (wherever applicable) higher credit ceilings. Output will increase and its structure will improve to some extent.

This is, on practical grounds, what has happened in Poland in the summer of 1990. As the level of economic activity began inching upward after the sharp fall in January/February 1990, stimulative monetary policy (maybe too stimulative, see the preceding section) raised the output growth rate. Industrial output increased in August and September by impressive 7.6 per cent and 8 per cent on a month-to-month basis. No doubt, part of it was an increase in output by protected large monopolists. But in tandem with this adverse outcome better performers increased their output rate - and their share in total output. Not only did the output level get higher (a rather normal consequence of macroeconomic stimulation), but the output structure improved, too. Inflation, however, continued as it did under a more restrictive policy. Obvious recommendations here seem to be a less hasty manipulation of the interest rate, smoother changes (if necessary) and - most importantly - the application of some specific measures addressing the problem of linkages between "nobody's" banks and "nobody's" enterprises.

For quite apart from a critical view of overhasty reactions to short-run changes in the inflation rate, a more fundamental critique should be raised against the government's philosophy of monetary policy. Throughout the period under consideration there has been little understanding of the increasingly obvious fact that orthodox monetary measures, such as manipulation of the interest rate, may be necessary but not sufficient to cope with persistent inflation under an ownership structure different from that found in macroeconomics textbooks.

The first-best solution to the problem of perverse behaviour of "nobody's" banks and "nobody's" industrial enterprises is, of course, privatisation, especially that of banks. As this solution needs more time than has been originally expected (apart from mistakes in privatisation strategy and tactics made by the government, see Beksiak and Winiecki [1990]; Gruszecki and Winiecki [1991]), some second-best solutions are called for. The author has the following "philosophy of intervention". Reasonably well-functioning markets do not require intervention (search for the Pareto-optimum, unattainable in real-life conditions, does more harm than good). Where markets do not function reasonably well, an intervention vis-à-vis a class of economic agents is preferable to that against specific economic agents [see also Williamson, 1985; 1988]. The worst thing that may happen to an economy is "hands-on" management by policy-makers that sooner or later dissolves into an "everything-is-bargainable" type of economy. For Poland it would be a return to the dreaded past of the STE.

Therefore the author suggested [Winiecki, 1991c] for one class of economic agents, that is industrial SOEs, that commercial banks should be ordered to make a compulsory analysis of industrial SOE's cash flow, combined with that of SOEe' mutual indebtment. For it should be remembered that one way to survive has been for SOEs not to pay their suppliers: and since suppliers had few other clients they have been reluctant to start bankruptcy proceedings. Banks' analyses would reveal which SOEs generate a positive cash flow and - in the case of owing more than being owed - whether a net cash flow would be high enough to pay the bills in a reasonable time span.

This is what commercial banks should have been doing all along, but for reasons explained in the preceding sub-section they do not. Therefore, the central bank's guidance should force the banks to make such simplified analyses of their clients viability and, on the same basis, **automatically** refuse further lending to SOEs that generate a negative cash flow or to those whose cash flow is lower than the negative balance of mutual indebtedment. Or some alternative measures could be applied, e.g. buying a debt of that sort by the central bank, as suggested in a discussion by Aleksander Jedraszczyk, or even abolition of all debt of SOEs vis-à-vis state banks and other SOEs (as suggested by Steinherr, Perée [1991]).

The stress on automacity of bank behaviour has obvious causes. It should help to avoid political pressure on commercial banks and resultant degradation of a proposed measure into yet another way of "hands-on" management. There will certainly be some casualties of the automacity but the lack of it would be certainly much costlier. There are, as stressed above, other unorthodox measures that could make orthodox monetary policy work better (at a minimum - in a non-perverse way). On these second-best measures hinges the possibility of success of a monetary policy that at present seriously endangers the whole stabilisation programme.

IV. "Autonomous" Macroeconomic Policy Errors

Apart from problems resulting from weak understanding of the interaction between state-owned banks and industrial enterprises, as well as its consequences for macroeconomic balance, macroeconomic policy has suffered from "autonomous" police errors. By the latter I understand policy errors unrelated to micro-macro linkages analysed in the preceding section. The first, most striking (although not necessarily most fateful) have been interventionist "itchings" at the macro level. The tendency to react to each and every change in macroeconomic (in particular inflation) indicators, accentuated rather than smoothed the transition from near-hyperinflation-cum-stagnation, to falling inflation-cum-recession, to price stability-cum-recovery.

Nervous, overhasty decisions, particularly on monetary policy matters, resulted first in accelerated recovery and later stagnation and decline. The Polish economy went through a full cycle from recovery to recession in less than a year. Apart from adjustment costs in terms of the shift from old STE-type pattern of behaviour to a market-type behaviour, enterprises had additionally to incur costs of adjustment to the changing cyclical situation of the economy. In the stylised pattern of the business cycle these adjustments pay back over the time span of the (stylised) cycle. Within the framework of a cycle measured in terms of months rather than years **only** costs are incurred. Some part of the problems Polish SOEs encounter presently undoubtedly stems from extra costs incurred as a result of this "compressed" cycle.

What is of analytical interest here is the extremely strong correlation between changes in the monetary policy stance and output changes. Furthermore, the lag between the former and the latter is markedly shorter (and also seems less variable) than asserted by monetary theory. A look at Table 5 where interest rate changes are set against industrial output changes lagged by just one month reveal a marked correlation between the two variables.

If this correlation were more than an ephemeral phenomenon, a whole range of questions should be raised. The first is, of course, one about the sources of such unusual sensitivity to changes in monetary policy. There is little theoretical and empirical groundwork in this respect (quite unsurprisingly, given the short time span of the transition), so that it is only informed guesses that can be offered here on the basis of knowledge of the traditional STE.

Enterprises in an STE, whether an orthodox Stalinist one or a "reformed" Hungarian or Polish type, were extremely wasteful. Their inventories were gener-

Table 5 - Interest Rate and Industrial Output Rate, April 1990-June 1991

	Basic monthly lending rate of the central bank (lagged one month)(a)	Industrial output (monthly rate)(b)
April 1990	10.0	98.5
May 1990	8.0	100.3
June 1990	5.5	104.9
July 1990	4.0	87.8
August 1990	2.8	107.6
September 1990	2.8	108.0
October 1990	2.8	100.4
November 1990	3.6	100.0
December 1990	4.6	103.2
January 1991	4.6	82.4
February 1991	4.6	100.8
March 1991	6.0	100.1
April 1991	6.0	91.7
May 1991	6.0	98.3
June 1991	4.8	100.8

(a) Beginning with March 1990 rate. - (b) Preceding month equal 100.

Source: See Table 4.

ally very much higher than those of their privately owned counterparts in the West. They used much more materials per unit of output (and per one dollar of GDP). But they were always much more strongly controlled with respect to possession and use of monetary balances. This was the case quite apart from inadvisability of keeping any larger part of their current assets in the form of cash or demand deposits in a shortage-plagued economy.

The author's hypothesis is that at the beginning of the transition process SOEs in Poland found themselves short of money under the changed supply/demand conditions and resultant requests for prompt payments for the deliveries. In the mature Western market economy a sudden increase in demand for monetary requirements would be met either by the sale of less liquid assets of the firm (various instruments of the money market such as treasury bonds, large certificates of deposit, etc.) or by short-term credit.

Since enterprises in an STE did not have (and were not allowed to have) the former, they had to depend on the latter. However, the latter became extremely costly with the beginning of the transition programme - and macroeconomic restraint. True, they have found some other sources of financing for the time being (see the first section) but the overall, so to say, "level of monetisation" of Polish enterprises remained rather low relative to their Western counterparts. There are certain standard measures in analysing the financial structure at the enterprise and/or industry level (see, e.g., Rybczynski [1982], in analysing the structural change in British industry), but they cannot be used in direct comparisons due to the existence of various distorting factors and incomplete data on SOEs' financial situation. Thus, the foregoing cannot be easily empirically proven. Nonetheless, I think that part of the problems of industrial SOEs stems from their unusually high sensitivity to interest rate changes.

The second "autonomous" policy error of the government concerns the timing of the second round of restrictive macroeconomic policy. Apart from nervous reactions to monthly changes in the inflation rate, the decision to drastically tighten monetary policy through sharp rises in the interest rate in October and November 1990 had momentuous consequences. In fact it is this decision that pushed the Polish economy into the second recession in the autumn of 1990.

In the preceding section I criticised the rationale for this decision. What I see as a major "autonomous" policy error is the **timing** of this decision. For let us assume for the sake of argument that the government was right in seeing the September 1990 increase in inflation vis-à-vis that of August 1990 as a sign of rekindled inflation and not as a return to the underlying inflation rate registered since March 1990. Was it right, under the circumstances, to raise the central bank's basic lending rate from 34 to 54 per cent on an annual basis just at that time, i.e. in October and November?

My answer is an unequivocal no. The government, just as everybody else conscious of the changes in our trading relations with the Soviet Union and other ex-COMECON countries, knew at that time that the change from the transferable rouble to convertible currency trade would dramatically reduce our eastbound exports. Many talked at that time about halving our exports in this direction.

Now, exports in 1989 amounted to 16.5 per cent of GDP (measured according to SNA) and exports to COMECON countries to 5.8 per cent of GDP. In 1990 exports increased while GDP fell according to preliminary estimates by 12 per cent. Thus, the share of exports, including that of eastbound exports increased as well. Therefore it could easily be estimated that a halving of our eastbound exports in 1991 would create a strong recessionary impulse amounting to about 4-5 per cent of GDP. With a severe recession looming over the economy and expected to exert its influence already in January 1991, the sharp rise in the interest rate amounted to an overkill. The economy halted in October (possibly for seasonal reasons), but more ominuously remained flat throughout the rest of the year under the impact of tightened monetary policy..

When the recessionary impulse from falling foreign demand came in January, the economy fell over the precipice: industrial output declined by 18.3 per cent in one month. Yet another increase in the central bank's basic lending rate in late January "ensured" that the recession would continue - and it did (or does, as the bottom of recession has not been reached at the time of writing, i.e. in June 1991). I regard the apparent inability of the macroeconomic team to correlate determinants of the macroeconomic situation at the turn of 1990 and 1991 as the biggest - and at the same time most easily avoidable - macroeconomic policy error.

In the same category of "autonomous" policy errors the present writer puts excessive devotion to a fixed exchange rate in a highly inflationary economy. I myself accepted at a certain point the argument put by Jeffrey Sachs that under near-hyperinflationary conditions stability of the exchange rate has a positive psychological impact on economic agents (a reflection of this argument could be found in Beksiak et al. [1989]). But there is a sea of difference between maintaining a fixed exchange rate for a few months at the start of the stabilisation programme and keeping a fixed exchange rate for the whole year in the face of a more than three times higher CPI (and almost three times higher quasi-WPI). Unfortunately, devotion to fixed exchange rates is shared by influential international institutions, such as the IMF, that support fixed exchange rates as a part of the adjustment package. But again, knowledge of local conditions is worthwhile as it helps to avoid pitfalls that undermine the impact of the package.

A fixed exchange rate in the case of a temporarily disequilibrated Western market economy may pressure domestic producers not to rise prices under the threat of cheaper imports. A fixed exchange rate is indeed anti-inflationary. However, this works reasonably well in the short run and with inflation rates in the range of, say 5-15 per cent on an annual basis. Since March 1990 inflation rates in Poland on a **monthly** basis fluctuated on the average between 3 and 5 per cent with large monthly fluctuations. Maintaining a fixed exchange rate from January 1990 till May 1991 under such circumstances (in the face of quadrupling prices) undermined the competitiveness of Polish enterprises instead of improving it. For it is necessary to inject competition to what has otherwise been a highly concentrated economy. But at the same time few enterprises, whether SOEs or privately owned, can succeed in reducing their costs by more than 60 per cent within a year (this was the percentage by which the dollar's value fell in zloty terms).

A good saying the present writer once read is worth repeating here: "Not every kick in the pants galvanises; some merely hurt". An overdose of the medicine has had perverse effects as the bulk of industrial enterprises have been threatened with bankruptcy. Once again ignorance of differences in local conditions in applying standard policy measures resulted in perverse effects. The injury is all the greater for this author stressed in the preceding section that it is the better not the worse SOEs that have been more adversely affected by monetary policy.

An obvious conclusion is that a fixed exchange rate regime should have been changed into a flexible exchange rate regime months ago or, at the very least, given the dominant Keynesian philosophy of the government's macroeconomic team, that the fixed exchange rate should have been smoothly adjusted in the face of the rapidly changing domestic price level. This theoretically sound rationale is, however, overwhelmed by very difficult technical problems of such an adjustment. The answer to the question as to when and by how much the exchange rate should have been changed is extremely difficult in the face of the distorted prices until 1990.

Nonetheless, some benchmarks could be established. The government devalued the zloty substantially on January 1, 1990, in expectation of a rapid price increase after the liberalisation of domestic prices. Devaluation in real terms was even larger than the nominal one by about 30 per cent (as suggested by still greater differences in a "guesstimated" purchasing power parity in traded goods). That gave the government room for maintaining a fixed exchange rate for some time. Erosion of competitiveness became very strong at a certain point, though.

I think that a reasonable benchmark for managing the exchange rate could be established by reference to changes in domestic prices relative to black market (and later gray market) exchange rates in the past and the official rate in 1990 and 1991. These changes were markedly uncorrelated because the foreign exchange market rationally adjusted its expectations of future inflation more quickly (and acted upon it by devaluing the zloty) than either the government with respect to centrally set prices or SOEs with respect to decentralised prices. As the reference time frame I suggest 1988, that is the last year that witnessed on export surge before transition. Substantial devaluation in late 1987 resulted in a large increase in convertible currency exports in 1988 (by 17.4 per cent in current US$). Regardless of a choice of benchmark, **some** benchmark should have existed for a smooth adjustment of the exchange rate.

Delayed exchange rate adjustment also helps to explain missing benefits of the second phase of the opening-up of the Polish economy. International trade textbooks stress two-phased benefits. First, as selling abroad becomes more (or at all!) profitable, firms shift a larger part of their output abroad. A second - and more important - phase comes when greater profitability entices existing firms in the export sector to invest in order to increase their export capacity and new firms to shift resources to the export sector. However, a shift of recources is rarely based on firms' own resources only and the second credit squeeze since the autumn of 1990 strongly discouraged investment. On top of it, profitability of export orientation has been declining fast with the exchange rate unchanged and domestic inflation increasing by 3-5 per cent on a monthly basis. Doubly discouraged, the export shift petered out toward the end of 1990 and did not register marked recovery until now (in spite of a further dramatic fall in domestic demand and an increased pressure to export).

Lastly, it is impossible to make an overview of macroeconomic policy in the period under consideration without mentioning another stone around its neck, that is wage controls. I have criticised so many times this particularly harmful measure in the context of the Polish transition programme [see, e.g., Beksiak et al., 1989; Beksiak, Winiecki, 1990; Winiecki, 1990a; 1990b] that I feel absolved from taking up the subject thoroughly once again. Therefore only some aspects of the problem will be mentioned here. First of all, and this ceterum censeo should be repeated every time, wage controls shift the conflict from micro (enterprise) to macro (government) level, leading to unnecessary politicisation of wage claims. The harm done in the longer run heavily outweighs benefits of such a policy in the short run (if there are any, as maintained by Bruno [1990], Dornbusch and Simonsen [1987], and others).

In the particular time and place of the Polish transition between mid-1990 and mid-1991, the government instead of abandoning wage controls chose the worst possible way, that of manipulating the rules established earlier by itself. Worse still, under strike pressure it did not abandon wage controls but reduced their impact by case-by-case concessions. Since concessions were usually given not to the most efficient but to the numerically and politically strongest, these concessions brought about no efficiency gains (the opposite in fact has been the case). Furthermore, the credibility of wage controls was seriously undermined, thus inviting more and more strike pressure.

V. Credibility of Economic Policy: A Missing Factor in Government's Considerations

Since the late 1970s one of the hottest topics in economic theory has been the credibility of government economic policy. Concern with credibility stemmed from the fact that apparently reasonable policies did not bring about the expected effects (or even resulted in perverse ones) when government's policies were regarded by economic agents as not credible. Some theorists stressed time inconsistency of policies and their perception as being inconsistent by economic agents [see Kydland, Prescott, 1977], some others analysed conditions that led economic agents to believe that policy-makers abandoned interventionist stance in favour of a stable rule (see Barro and Gordon [1983] and, in a slightly different context, Neumann [1990]). Still others explained the persistence of intervention by underlining benefits to policy-makers stemming from intentional ambiguity in the face of informational asymmetry with respect to policy-makers' intentions between policy-makers and the public [see Cukierman, 1986; Cukierman, Meltzer, 1986]. The foregoing did not exhaust all strands of thinking about the credibility issue (see, e.g., contractarians' works with respect to uncertainty reduction through rules on policy-making).

Whatever the achievements of various strands of economic theory, unfortunately none of these was taken into account in economic policy-making by the Polish government in the transition period. Analysing its macroeconomic policies, one gets the impression that policy-makers mistook political support for the government for credibility of particular policies. Regarding political support for the government as high, they apparently did not think it worthwile to tailor particular policies with the credibility in mind. No positive reinforcements for particular policies have been gained from policy design as a result.

Unfortunately, general support for the government of a given political colouring does not mean that the behaviour of economic agents with respect to a particular policy will be in concordance with policy-makers' expectations if a particular policy does not look credible. Monetary policy in 1990 serves as a good example here. The transition programme started with an announced restrictive macroeconomic policy stance. On the surface, words were followed by deeds: the interest rate, for example, was raised very sharply on December 31, 1989, to 36 per cent for the month of January 1990. But in reality signals were mixed at best.

As I stressed in the second section, government was announcing the need for a restrictive macroeconomic policy months in advance but at the same time did very little to stop the inflow of cheap money and real resources to SOEs before the "big bang". Real interest rates remained strongly negative from September till December, cheap imports continued to flow in, fueled by an undervalued exchange rate till the last days of 1989. Judging by the most recent past, enterprises might have been partly justified in their expectations that the restrictiveness is a temporary phenomenon and things will be "back to normal" (in fact: abnormal) soon. Even after the beginning of the transition programme the government that abolished export earnings retention quotas did not in any way neutralise the money that SOEs later converted into zlotys and used as a cash balance support in the early months of 1990. Thus, signals continued to be mixed and supported the natural unwillingness to adjust. A wait-and-see or minimum adjustment attitude on the side of most SOEs was not completely unjustified.

Mixed signals that undermined the credibility of macroeconomic restraint could have ended in the second half of 1990 as sources of financial support for enterprises (cheap inputs from the past, foreign exchange earnings converted into zlotys) began drying up. Credibility of the government's commitment to restrictive macroeconomic policy might have increased as a result. However, the government shifted to a more accommodative policy at about the same time (summer 1990). As a consequence, SOEs got a strong signal that things might be, after all, moving "back to normal"; this was obviously not true but such were the credibility-related consequences of the policy change at this particular moment. And, let it be noted, the confusion resulting from the difference between government words and government deeds in the summer and autumn of 1990 (see the first section) did not add to the credibility of macroeconomic policy, either.

In some cases policy-makers themselves **directly** contributed to undermining the credibility of their own policies. Again, monetary policy is illustrative here. A look at the term structure of interest rates (see Table 6) reveals that the policy-makers themselves do not believe in the success of their attempts to eradicate inflation. Time deposits in commercial banks for varying periods from one month to two years carry interest rates indicating strong expectations of accelerating inflation in the coming years.

Table 6 points to the fact that not only commercial banks expect inflation to be higher the longer the time span (because time deposits carry higher interest rates for three months than for one month, for six months than for three months, etc., with the highest interest rate for two years), but the spread was **increasing** throughout October 1990-April 1991. This term structure did not come from nowhere. It is dictated primarily by the interest rate paid to commercial banks for

Table 6 - Term Structure of Interest Rates on Deposits in the Central Bank (annual rates)

Type of deposits	Until January 30, 1991	From February 1, 1991
Demand deposits	9	12
Time deposits:		
6 months	30	64
12 months	39	68
24 months	44	70

Source: Narodowy Bank Polski: Sprawozdanie z Realizacji Polityki Pienieznej w I Kwartale 1991 (quarterly), mimeo.

their deposits in the central bank. In this manner the central bank undermines the credibility of its own policy.

This is not the end of credibility-undermining policy actions made by policy-makers. The exchange rate policy is not free from such problems, either. The increasing divergence between the stability of the exchange rate and the rapid inflation rate caused a lot of speculation about the imminent devaluation of the zloty. Firm denials to the contrary, reality had to reassert itself at a certain point. But immediately after devaluing the zloty in May by 16 per cent policy-makers again began their earlier declarations about defending the new parity of the zloty. Obviously, their pronouncements will carry much lesser weight in the future, and all the more so, as the zloty is still perceived to be overvalued.

Overall, mixed signals and resultant low credibility of macroeconomic policy was in itself a factor reinforcing weak adjustment. But macroeconomic policy was not the only area where credibility did not positively reinforce government policy (to say the least).

Trade with the Soviet Union was another example, although more one of ommission than commission. As exports to the USSR (and other ex-COMECON countries) collapsed after the shift to convertible currency trade, various ideas of temporary support were floated in government circles. To the best of my knowledge, however, none of the proposed schemes had the credibility reinforcing mechanism built into a scheme. The whole idea of temporary support is based on the premise that SOEs dependent on the Soviet market should have the time necessary for adjustment to the new and more demanding conditions of convertible currency trade. Therefore, whatever the scheme, it should have a declining degree of support built into it from the start.

Assuming, for example, support through tax relief for SOEs which exported, say, more than 30 per cent of their output eastward, tax relief extended over some 18 months should give full percentage of planned relief for the first 6 months, two third of the tax relief for the next 6 months and only one third for the last 6 months of the scheme. In this manner, even if the first 6 months were wasted without any adjustment whatsoever, the reduction of tax relief would serve as a signal that the government is serious about adjustment. The credibility of this particular policy would be enhanced and, consequently, prospects for adjustment would improve.

Credibility may be equated with a stock that, just as any other, may increase or decrease as a result of policies pursued. Increases or decreases take place at a rate that is somehow related to the delay between policy pronouncements and actual policy actions. The smaller the delay, the more the stock increases, and vice versa. In the case of governments of long standing or political groupings returning to power with a certain record of past policy-making, there may be quite a substantial stock of credibility and one or two slip-ups will not draw down the stock too heavily. But this is not true of a new government, no matter how strongly supported on a general political plane. Regardless of strong general support, a few credibility-reducing mistakes may draw a given policy's credibility down sharply, as the stock of credibility from which to draw is not large. Moreover, whatever credibility has been there, it was given on (easily callable) credit. Polish government policies have been strongly - and adversely - affected by the lack of understanding of the problem in question.

VI. In Place of Conclusions

The present writer began his assessment with the reference to an earlier one concerning the first half of 1990 [Winiecki, 1990a]. Prospects for success were at that time rather high although I was cautioning against easy optimism and criticised the privatisation-cum-demonopolisation part of the programme [see Winiecki, 1990a; Beksiak, Winiecki, 1990]. The year that passed between mid-1990 and mid-1991 changed the prospects markedly. Accumulating policy errors, as well as perverse results of some pursued policies, undermined prospects for success in the short run.

Inflation did not subside, while the economy slid into a second recession in just so many years. Worse still, the structure of output has got progressively worse as better enterprises have been facing bankruptcy much more often than politically strong but economically less efficient ones. Supported by advice based on ignorance of the STE legacy, the government's macroeconomic team keeps an unchanged course that may result in a bankruptcy threat for a large share of SOEs.

Now, if it is dozens of SOEs that simultaneously go bankrupt, government way weather the storm somehow. The situation changes dramatically if numbers increase from dozens to hundreds (or more). Faced by the looming collapse of a large share of industry, government may give in to the pressure for relief. However, under the weight of large numbers relief cannot be anything else than wholesale. As every enterprise gets relief because large numbers overwhelm government's and everybody else's ability to differentiate between classes of more and less deserving SOEs (see second section of the paper), the effort and sacrifice of the preceding 18 months may largely be lost. The stabilisation programme will have to start again and with much less credibility than the failed programme of 1990-1991 (as well as with much lower willingness to continued belt-tightening).

But the prospect of the failed stabilisation programme and the need for a second round of stabilisation medicine may not necessarily be the end of the dismal story. Not only the government but also the idea of a rapid transition to the market system may become discredited in the process and an election may bring victory to some populist, "third way" type of coalition that will radically change the direction of transition. If this were to happen, prospects for success would disappear in the medium run as well. Years may have to pass before another, this time hopefully more sensibly executed programme aiming at the same target, i.e. a capitalist market economy, will become a political reality.

Bibliography

BARRO, Robert J., David B. GORDON, "A Positive Theory of Monetary Policy in a Natural Rate Model". The Journal of Political Economy, Vol. 91, 1983, pp. 589-610.

BEKSIAK, Janusz, Jan WINIECKI, "A Comparative Analysis of Our Programme and the Polish Government Programme". In: The Polish Transformation: Programme and Progress. Centre for Research into Communist Economies, London 1990.

--, Tomasz GRUSZECKI, Aleksander JEDRASZCZYK, Jan WINIECKI [1989], Zarys programu stabilizacyjnego i zmian systemowych (see English version: Outline of a Programme for Stabilisation and Systemic Change, in: The Polish Transformation: Programme and Progress. Centre for Research into Communist Economies, London 1990).

BERNHOLZ, Peter, Necessary and Sufficient Conditions to End Hyperinflations. Institut für Volkswirtschaft, Universität Basel, 1990, mimeo.

BRUNO, Michael, High Inflation and Nominal Anchors. Bank of Israel, 1990.

CUKIERMAN, Alexander, Central Bank Behavior and Credibility - Some Recent Theoretical Developments. Federal Reserve Bank of St. Louis Review, Vol. 68, May 1986, pp. 5-17.

--, Allan H. MELTZER, "A Theory of Ambiguity, Credibility and Inflation under Discretion and Asymmetric Information". Econometrica, Vol. 54, 1986, pp. 1099-1128.

DEMSETZ, Harold, Economic, Political and Legal Dimension of Competition. Amsterdam 1980.

DORNBUSCH, Rudiger, Mario Henrique SIMONSEN, Inflation Stabilization with Incomes Policy Support: A Review of the Experience in Argentina, Brazil and Israel. Group of Thirty, New York 1987.

--, Federico STURZENEGGER, Holger WOLF, "Extreme Inflation: Dynamics and Stabilization". Brookings Papers on Economic Activity, 1990, No. 2, pp. 1-84.

FURUBOTN, Eirik G., Svetozar PEJOVICH, "Property Rights and Economic Theory: Survey of Recent Literature". Journal of Economic Literature, Vol. 10, 1972, pp. 1137-1162.

GOMULKA, Stanislaw, Tworcza destrukcja (Creative Destruction). Zycie Gospodarcze, No. 18, 1991.

GRUSZECKI, Tomasz, Jan WINIECKI, "Privatisation in East-Central Europe: A Comparative Perspective". Aussenwirtschaft, Vol. 46, 1991, No. 1, pp. 67-100.

Informacja o liczbie przedsiebiorstw ktore wedlug oceny bankow nie posiadaja zdolnosci kredytowej (Information on Enterprises Which According to Banks Lost Their Creditworthiness). Narodowy Bank Polski, Warsaw 1991, mimeo.

JENSEN, Michael C., William H. MECKLING, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure". Journal of Financial Economics, Vol. 3, 1976, pp. 305-360.

KYDLAND, Finn E., Edward C. PRESCOTT, "Rules Rather Than Discretion: The Inconsistency of Optimal Plans". The Journal of Political Economy, Vol. 85, 1977, pp. 473-492.

NEUMANN, Manfred J.M., Precommitment to Stability by Central Bank Independence. Prepared for the Fourth Hayek Symposium on Knowledge, Evolution and Competition, Freiburg, June 9-12, 1990, mimeo.

RYBCZYNSKI, Tadeusz M., "Structural Changes in the Financing of British Industry and Their Implications". National-Westminster Bank Quarterly Review, March 1982, pp. 25-36.

STEINHERR, Alfred, Eric PEREE, Privatisation in Eastern Europe: Some Concrete Proposals. Paper prepared for the Kiel Week Conference on Transformation of Socialist Economies, Kiel, June 26-28, 1991, mimeo.

WILLIAMSON, Oliver E., The Economic Institutions of Capitalism. New York 1985.

--, "The Logic of Economic Organization". Journal of Law, Economics, and Organization, Vol. 4, 1988, pp. 65-93.

WINIECKI, Jan, Large Industrial Enterprises in Soviet-Type Economy: The Ruling Stratum's Main Rent-Seeking Area. Communist Economies, Vol. 1, 1989, No. 4, pp. 363-383.

-- [1990a], "Post-Soviet-Type Economies in Transition: What Have We Learned from the Polish Transition Programme in Its First Year?". Weltwirtschaftliches Archiv, Vol. 126, 1990, pp. 765-790.

-- [1990b], "Walesa Must Resist the 'Reflation' Siren Song". Wall Street Journal, December 21, 1990.

-- [1990c], Kilka uwag o gospodarce wazych dla nowej ekipy ekonomicznej rzadu (A Few Remarks on the Economy Important for the Economy Management Team of the New Government). Warsaw, December 1990, mimeo.

-- [1991a], Resistance to Change in the Soviet Economic System. Property Rights Approach. London 1991.

-- [1991b], Political Economy of Privatisation: Poland in Comparative Perspective. Institut für Weltwirtschaft, Kieler Arbeitspapiere, 485, August 1991.

-- [1991c], Inflacja i wzrost gospodarczy a polityka rzadu (Inflation, Economic Growth and Government Policy). Warsaw, March 1991, mimeo.

-- [1991d], "The Inevitability of a Fall in Output in the Early Stages of Transition to the Market". Soviet Studies, Vol. 43, 1991, pp. 669-676.