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Economic Reforms in Poland:

Implications for Agriculture

by

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1. Introduction

The last few years have witnessed the most significant political and economic changes in Europe since the end of World War II. As the countries in Central and Eastern Europe shed the remnants of Communist governance, they struggle with the process of adjusting to a Western-style democracy with a market oriented system. The countries in the former Soviet sphere of influence face fundamental economic and political disintegration. At the same time, they are confronted with the task of reintegration into Europe and the world economy. The strategies of reform pursued differ from country to country, ranging from an economic shock therapy of rapid introduction of deregulated prices, as in Poland, to a gradual

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introduction of market economic elements in other countries such as Russia. Regardless of the speed and strategy of economic and political reform, it appears that most countries' process of transition has been delayed or temporarily halted by unexpected economic and/or political problems, which in some countries may even jeopardize the reform itself as evidenced by the growing popularity of conservative parties in several countries in Central and East Europe.

Throughout the world, agriculture has become integrated into the economy at large. Therefore, it is not possible to analyze the process of economic and political transformation of agriculture without reference to the general thrust and speed of reform (Pasour, 1992). In this paper, we will argue that Poland, like other countries in Central and Eastern Europe, faces a dilemma of economic and political reform. Further, we will discuss some of the central variables which tend to constrain the process of economic transition and recovery.

Following we will first discuss some of the central effects of partial and stepwise economic reform. Second, we will analyze the pros and cons of economic shock therapy, i.e., of a rapid switch to a market economic system and its implications for institutional change. Third, we will try to shed light on some of the political economic aspects of transformation. Fourth we will discuss a number of factors constraining the speed of economic recovery. We will conclude with some remarks about the prospects for economic transition in Polish agriculture.

2. Partial Reform and Economic Distortions

Several countries in Central and East Europe, such as Russia, have chosen a rather cautious approach to reform in that they pursue changes gradually, leading to extended periods of partial reform. In this process, there may be price liberalization and privatization in some sectors of the economy, while in others ownership does not change and core elements of central planning remain in place. Obviously, this strategy of economic transition aims at avoiding a sudden shock of adjustment to a market economic system while retaining some flexibility to correct unanticipated economic, social, and political problems before they reach a magnitude that could jeopardize the long-run success of reform. At the same time, reformers obviously also hope to have sufficient time for political decision making on and implementation of institutional arrangements that are necessary in order for markets to allocate scarce production factors and goods efficiently. However, it has now become apparent that in many cases the gain in efficiency in the sectors with price reform are outweighed by additional distortions created by partial rather than full fledged market economic reform. As a consequence, the first phases of reform which aimed at improving the performance of the economy, ultimately contributed to its further deterioration.[1]

[1] The very early experience with reform in the former Soviet Union can serve as an example. Partial economic reform began in 1988 when workers were allowed to form private cooperatives and lease capital from their firms. By the end of 1990 about five percent of employment resulted from this kind of economic activity. However, most prices had remained regulated, state ownership of many enterprises had been maintained, and central planning of many goods and inputs had remained in place. Despite partial economic reform, the economy deteriorated and, at times, appeared to be close to collapse. For details of the economic decline under partial reform in the former Soviet Union see Shleifer and Vishny (1991); World Bank, et. al. (1991).

To illustrate some of the effects of partial reform consider the following example.[2] Assume a closed U.S. economy in which farmers in the state of Minnesota produce all the wild rice, which is then sold in all 50 U.S. states. Assume further that the market clearing price of a pound of wild rice is $5.00, and that initially all states impose a maximum price on wild rice which is $4.00 per pound. At the maximum price, demand will exceed supply. Lines may form in front of stores selling wild rice, and there is likely to be a black market for wild rice. Now assume some Midwestern states drop the maximum price. As a consequence, consumers in these states get all the wild rice they want at the now prevailing market price while consumers in other states get the remaining wild rice, if any. Consumers in the Midwest are even better-off under this policy than under a free market system, while consumers in the rest of the United States receive even less wild rice than under a uniform maximum price.

Now consider a modification of this scenario and assume that wild rice is produced in two U.S. states, Minnesota and California. Now as before let the maximum price be $4.00 per pound and the market price $5.00 per pound. Under a nation-wide maximum price policy the economic effects would be, in principle, the same as in the first scenario. However, now assume that the maximum price is lifted only for producers in one state, say Minnesota. Farmers in Minnesota can now sell as much wild rice nationwide as they please at the now prevailing market price, while California producers would still face the maximum price and they would produce as much wild rice as before. Obviously, the market price under partial price liberalization would be higher than under complete price liberalization. Therefore, Minnesota's wild rice production would attract additional resources which, on the margin, would be less

[2]This is the Minnesota version of an example found in Murphy, et. al. (1992).

efficient, and Minnesota farmers would produce more wild rice than under complete price liberalization.

Obviously, if the maximum price is lifted for California farmers as well, total U.S. production of wild rice would be higher than under partial liberalization. Minnesota farmers would face increased competition from California farmers and the market price would decline. Income of Minnesota wild rice farmers would decline, and less efficient farmers may have to quit wild rice production altogether.

To clarify the discussion further, consider a simple model of partial price liberalization in agriculture.[3] Assume agriculture produces one good using one variable input. Let the good be wheat and the input be mineral fertilizer. Assume also the prices of both fertilizer and wheat are kept below free market prices. This policy was typical of agriculture in many Central and East European countries under central planning. The price of food was kept low to appease the urban population while input prices were subsidized in an attempt to offset the disincentive effect in production of low producer prices.[4]

Now assume that for some farms, we will refer to them as private farms, price regulation does no longer apply. They can negotiate the fertilizer price with producers of fertilizer and they can sell wheat at whatever the market price is. The other farms, we refer to them as state farms, continue to buy fertilizer at the regulated maximum price and sell to the state at the established maximum price of wheat. Obviously, private farms will now supply wheat at market

[3]Murphy, et. al. (1992) discuss a range of similar scenarios.

[4]As has been observed, in many cases prices were also kept below market clearing levels, so planners could collect bribes. Shleifer and Vishny (1992).

clearing prices and they will sell more than under complete price liberalization. Private farms' demand for fertilizer will increase despite its higher price, and the amount of fertilizer sold to state farms will decline, reducing the production of wheat by state farmers under partial price reform. Private farms now are better off than under complete price liberalization because they face less competition in both the fertilizer and the wheat market.

Figure 1

The economic implications of partial and complete price liberalization can be illustrated graphically. Figure 1 depicts the effects of a maximum price and of partial price reform relative to a free market price policy for wheat. Panel (a) depicts the supply function of private farms, (b) of state farms and (c) shows the market supply of and the market demand for wheat. For simplicity of graphical exposition it has been assumed that the private and state farm sectors have identical supply functions, and that under a system of price liberalization domestic supply would equal domestic demand at world market prices (p_w). Under central planning both private and state farms would receive the maximum price, p_m. At this price, market demand would exceed supply by $q_m^* - q_m$. If price regulation is lifted for private farms under partial reform, they receive P_{pr} which exceeds the market price under complete liberalization. Therefore, partial liberalization makes private farms better off than a free market system and thus attracts more resources to those farms than would be used there under perfect competition.

Figure 2

The effect of a maximum fertilizer price and partial price reform are depicted in Figure 2. Again it has been assumed that under free trade domestic supply would equal domestic demand. The equilibrium price thus is r_w, while f_w represents the quantity of fertilizer used in the economy ($f_w^p + f_w^s$). Under central planning, fertilizer producers would be allowed to sell at $r_m < r_w$. At this price, domestic demand would exceed domestic supply by $f_m^* – f_m$. In this situation there is no difference between private and state farms. Therefore, in Figure 2 it has been assumed that each category of farms receives half the total fertilizer production ($f_m^s = f_m^p = fm/Z$).

If, under partial price liberalization, fertilizer producers are free to negotiate with private farms, the new price will be below the competitive price r_w . Again the private sector would attract more resources than under perfect competition, and would be better off economically as the fertilizer price is below r_w . If the central planners require fertilizer producers to sell the same amount of fertilizer to state farms at r_w that was sold before partial price reform, and this could actually be enforced, state farms would receive the same amount of fertilizer as before. The price private farms had to pay would be $r_{pr} < r_w$.

However, in reality this is not likely to happen because producers have an incentive to sell fertilizer to farmers at a price above r_m. In fact, as economic reform progresses, enforcement of quotas is usually no longer possible. In the extreme case in which all the fertilizer ends up in the private sector, the fertilizer market price is $r_{pr}' < r_{pr}$ and production on state farms would decline to f_{pr}' (= 0).

The combination of partial price reform on both the wheat and the fertilizer market would accentuate the effects discussed above. More resources which at the margin are less productive, are employed in private sector firms than under perfect competition, and the state sector's production is likely to decline. As the market economic reform progresses, this preferential treatment of the private sector is discontinued, leading to a relatively higher number of business failures and making market economic reforms less popular among those affected.

Obviously, the result of partial price liberalization depends on the scenarios analyzed, including assumptions about which prices are liberalized, whether quotas remain in effect for private and/or state firms, whether those can be enforced and so on. The assumptions in our analysis were chosen to capture the essence of partial reform observed in some countries. The results obtained in this analysis point in the same direction as those obtained for alternative scenarios of partial liberalization (Murphy, et. al., 1992). Second best theory suggests that it is possible to find partial price reform scenarios that may represent an improvement over central planning as well. What is important to note, however, is that in many cases partial reform may be inferior to central planning; i.e., although reformers move in the right direction (towards market liberalization) the economy declines.

Certainly, there are many more variables determining the speed and success of economic transition than can be discussed in this paper. In our view, the analysis of a private/market economic sector and a state/centrally planned sector provides an interesting perspective of the economic decline of private farms in Poland after price liberalization.

If it is correct that the private sector tends to be better off with partial liberalization than under market economic conditions for all sectors of the economy, then the Polish experience is not surprising. Although typical private farms in Poland under central planning were small, farmers were able to make a living. The rest of the economy as well as a significant part of agricultural land in Poland was owned by state enterprises and was subject to central planning. Many inputs were explicitly or implicitly subsidized. This includes family labor which could be diverted from nonagricultural jobs at low or no penalties. And many of the goods produced by private farmers could be sold at the then prevailing market price, which usually exceeded the price set by the government. Although the prices received by farmers went up initially as a consequence of deregulation in agriculture, the economic success of existing private farms declined as the prices of purchased inputs went up. Moreover, consumer incomes declined markedly in the early phase of reform leading to a reduction in demand, and farmers now face increased competition with the emerging large private farms and with imports from abroad.[5]

[5] See also Kwienciński and Leopold (1993).

3. Economic Shock Therapy and Market Economic Institutions

In the comparative static framework discussed above, an immediate and complete price liberalization would avoid the temporary additional distortions and the accompanying economic decline. It would quickly lead to a new free market equilibrium, and it would avoid a lengthy period of transition. However, such a strategy tends to result in temporarily high social and private costs of adjusting to the new relative prices.[6] Moreover, and more importantly, simply ridding markets of price regulations imposed under a system of central planning will not automatically lead to a functioning market economic system. The "free market" equilibrium that would result when economic reform is restricted to just deregulating prices will tend to be different from a true competitive equilibrium. It may also result in social or distributive outcomes which are considered politically undesirable by reformers.

The reasons for this are quite simple. Markets do not function appropriately in a vacuum. In the real world, markets allocate scarce resources and goods efficiently only if they are embedded in suitable institutional arrangements, and if externalities have been corrected. Institutional aspects of reform are often overlooked, or they are not dealt with in analyses of economic reform processes because institutions are difficult to model formally and institutional models are particularly difficult to test empirically. But institutional arrangements matter for real world economic phenomena (e.g., Buchanan, 1989), and institutional change is crucial for economic and agricultural transformation in Poland and other countries in Central and East Europe (Stiglitz, 1993).

[6]In February of 1990 real wages in Poland were almost 50 percent lower than in December 1989. Average real income of private farmers in 1990 was less than 50 percent of the 1989 level, and in 1991, it was about 40 percent below 1990 income (Rapacki, 1993a).

In practice, market economic institutions need to perform a wide range of different functions. We can mention only a few of them here which, in our view, are crucial in the process of agricultural transition in Poland.[7] Market economic institutions must provide market participants with information. They must also assure market participants that they will actually receive what they contracted for and that compliance with market rules will be enforced. Crucial institutional arrangements that have to be in place are property rights which are consistent with a market economy in a democracy. A suitable legal system has to be put in place as well.

For a functioning market economy it is of pivotal importance also to become integrated into the world economy. Much of today's economic wealth in industrialized countries is due to the gains from international trade. Poland and other countries in Central and East Europe remain far from realizing their trade potential (Wang and Winters, 1992). Integration into the world economy requires full convertibility of the currency. It also requires a central bank which is allowed to function independently of the government. And, of course, capital markets require suitable institutional arrangements to efficiently allocate capital. This includes the regulation of the banking industry.

The banking needs of agriculture tend to be different than those of other private sector firms. In industrialized countries agriculture debt is more common than equity financing, a phenomenon which may have its origin in moral hazard and adverse selection problems. At any rate, this makes the institutional arrangements for an efficient banking sector particularly

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[7]As Pasour (1992) has pointed out, private property rights in agriculture need to be accompanied by many other institutions outside of agriculture if institutional reform is to be successful.

important for agriculture (Karp and Stefanou, 1993). As Figiel (1992) points out, the availability of bank loans continues to significantly constrain the transition process in Polish agriculture.

The market mechanism can result in an undesirable unequal distribution of income and wealth. For a market economic system to be politically acceptable it is, therefore, important to introduce social and redistributive policies, and also a fiscal system which makes it possible to finance social and redistributive policies without distorting market incentives.

Putting in place the institutional arrangements necessary for a functioning market economic system is taking most countries in Central and Eastern Europe more time than initially expected. This is the case even in countries such as Poland which have opted for swift economic reform and re-integration into the world economy.[8] As a consequence, market economic reforms do not immediately lead to quick economic recovery after the initial shock of adjusting to price deregulation, and the sustained economic recovery begins only as market economic institutions are introduced.

This constitutes the core of the dilemma of economic reform in Central and East Europe. Both a cautious approach to economic reform and to economic shock therapy lead initially to periods of economic decline. Of course, the decline in social welfare that tends to accompany economic transition does not make economic reforms particularly popular. In fact, in many countries in Central and East Europe this phenomenon has led to a growing popularity of conservative parties such as in Lithuania where a Communist government won democratic

[8]We will discuss some of the reasons for the delayed introduction of market economic institutions in Section 5.

elections in 1992. But also in Poland the popular support of reforms dwindled markedly during the period of poor performance of the economy. In 1991 when the Polish economy bottomed out, critiques of the market economic reform were twice as numerous as its supporters (Golébiowski, 1993a, b).

4. A Political Economic Dimension of Reform: Special Interest Groups and the Economic Constitution

Since the collapse of Communism, special interest groups have begun trying to influence the course of economic reform in Poland. Some of these groups had already been in existence under the old system, such as organizations related to the (former) Communist party or certain labor unions. Other special interest groups were founded only after reforms had begun.

So far, the influence of special interest groups has shown wide variations. In general, groups with homogenous interests, or relatively small groups tend to be more successful on the political economic markets. This is consistent with public choice theory. The single most important variable, however, determining the relative power of interest groups during the early phases of economic reform has been the amount of time a group has had to organize itself. Groups that already existed under the old system tend to be well organized; and they tend to be opposed to market economic reforms because they lose economic privileges enjoyed under the old system. This is the case not only for groups related to the former Communist party, but also for certain other groups which face economic decline. One example is coal miners in Poland. The coal industry was subsidized under central planning and coal miners were relatively well-off. With market economic reforms, miners faced erosion of subsidies and were consequently opposed to reform. Another example of a rather successful interest group that already existed before the collapse of Communism is private farmers in Poland. After the introduction of economic and political reforms, agricultural incomes declined. Farmers then demanded -- and eventually received -- subsidies in a variety of ways.[9]

Special interest groups matter for a different reason as well. During the process of economic reform, when many institutional arrangements are in flux and many major economic policy decisions have to be made, the political economic transactions cost tend to be low. The longer the period of transition is spread out and, thus, the more time special interest groups have to organize and lobby, the more influential they will be in affecting the crucial process of institutional choice for a functioning market economic system.[10] Of course, if an interest group succeeds in influencing institutional arrangements in its favor it will tend to be able to extract more political economic rents than if it has to influence political decisions within a given institutional framework that does not specifically favor its clientele.

These political economic considerations suggest that swift economic reform is preferable to a more cautious approach to changes in the economic system with a drawn- out process of transition and adjustment. A different approach to economic transformation may appear to be more suitable, namely to have market economic institutions in place <u>before</u> markets are deregulated and the economy is privatized.

Such a reform strategy, however, would have necessitated leaving in place the system of

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[9]Similar developments could be observed in Czechia and Hungary. For the extent of trade protection, see Karp and Stefanou (1993).

[10]Gardner (1987) has demonstrated for agricultural producer groups in the United States, that the longer a group has had to organize the more influential it tends to be.

central planning and the leading representatives of the old system, until the market economic institutions had been put in place. This was politically not feasible in Poland and other countries in Central and East Europe because of popular pressure to dismantle the old political and economic system, and because it would have meant leaving much political power to the Nomenklatura, which was slated to lose power after this important first phase of reform.

However, it is, in principle, possible to put an economic constitution in place at the early stages of economic reform, much like the new Polish constitution was agreed upon early in the political reform process. The economic constitution would spell out the principles of a market economic system and would contain binding rules for the design of market economic institutions and for economic policy.

Space does not permit us to discuss in detail the elements of a suitable economic constitution.[11] However, the economic constitution should aim at providing clear guidelines for the government, thus reducing the influence of special interest groups. Then it would be more difficult for governments to manipulate relative prices for reasons other than correcting market failures, and to abstain from activities in which the private sector is more efficient. Moreover, the economic constitution should lay out the principles of social and distributive policies in order to avoid distortions of market incentives. This would have to be accompanied by an abolition of institutions from the Communist era that govern special interest groups such that all groups are on an equal footing under the new system.

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[11]For a survey of constitutional economics see Buchanan (1990).

5. Constraints of Economic Transition

The process of economic and political transition and recovery has been and continues to be constrained by a number of additional variables. Several of them are discussed below.

5.1 Unexperienced Politicians and Public Administrators

As mentioned earlier, successful economic reform requires that the institutional arrangements consistent with a market economy are put in place quickly. This, however, has not always been possible for a number of reasons. Reform-minded politicians who came to power right after the collapse of Communism have tended to be individuals who were clearly opposed to Communism and who faced numerous impediments to political organization. The new generation of politicians has been rather experienced in organizing political opposition to Communism and related activities but, for obvious reasons, they have not had much experience with decision making processes in democracies. As a consequence, decisions on crucial pieces of legislation, including those on market economic institutions and on critical elements of reform have often been delayed. This has been aggravated by the fact that not all of the newly introduced democratic institutions are perfect yet, and the fact that parliamentary political stalemate has frequently delayed political actions even further.

In the 1991 election of the Polish parliament, 67 political parties competed for votes; 29 parties are presently (summer 1993) represented in the parliament. The strongest party has only 13.5 percent of parliamentary seats and four other relatively large parties have about 10 percent each. As a consequence, the process of coalition formation is time consuming. The coalition of Prime Minister Suchocka consisted of seven parties and was very instable and the time cost of decision making was very high. Frequently, decisions involved heavy package deals which compromised economic reforms. In June of 1993, President Walesa finally dissolved the Parliament and Poland has only a care taker government until elections can be held in September 1993.

Once economic reform legislation is passed, its implementation has sometimes been delayed as well. The reason has often been a lack of well trained public administrators experienced in implementing legislation in a democracy with a market economic system.

5.2 Social Sciences Human Capital

Economists have long recognized knowledge and skill as important variables of long run economic development and growth. In his 1890 book Principles of Economics, Alfred Marshall wrote: "Knowledge is our most powerful engine of production." Much later Theodore Schultz (1981), Gary Becker (1964) and others recognized the acquisition of knowledge as an investment in human capital, making it accessible to economic theory. As in economic development processes elsewhere in the world, human capital plays a crucial role for future economic growth in Poland.

Overall, the Polish work force is rather skilled in the traditional trades as well as in many other industries. However, there continues to be a shortage of social science knowledge, particularly in economics, management and law. In the past, social science training in these areas was based on Marxist theory and targeted to meet the needs of central planning. While in some countries, such as Poland, Czechia or Hungary, there exist cadres of social scientists trained in neoclassical economics and modern managerial theory around which training of future trainers, economists, managers and public administrators can be organized, this is not at all the case in some other countries. But even under the best of circumstances, the training of a sufficient number of economists and business managers will take many years. For the time being, it appears that the shortage of skilled business managers in Poland has led to a significant influx of former members of the Nomenklatura into newly privatized businesses. There they impose the traditional management practices and use their old network to obstruct the reform process (Rapacki, 1993b).

The shortage of well-trained managers and economists constrains economic recovery in Poland and in Polish agriculture. This shortage can be alleviated in the short-run by human capital transfer via import of economists and managers. In the longer term, foreign assistance can help a lot by helping train managers and economists and by training future trainers in universities, professional schools, and other educational organizations.

The training needs are in all traditional areas of economics and management sciences, ranging from managerial economics, to banking and corporate finance, to international trade, to micro- and macro-economics. But there also are urgent training needs in two areas which are sometimes overlooked. One is the interaction between private sector and government in a market economy with a democracy. Under central planning with state-owned enterprises the distinction between private sector and government was obsolete for obvious reasons. The other area is environmental management and consideration of environmental regulation in managerial decision making (e.g., Berger, 1993). Under Communism there were rather tight environmental regulations. However, they were not enforced and environmental considerations were essentially absent in managerial decision making.

The training needs in agriculture and the agribusiness mirror those of the economy at large. The potential for efficiency gains from training of farm managers is high in both the traditional small scale private farms as well as in the emerging larger private farms. The same is true for agribusiness managers, including those in the rural banking industry.

In addition to skilled business managers and economists, the process of transition is hampered also by an insufficient number of lawyers familiar with the new legal structure and with legal procedures in a democracy. As a consequence, important pieces of reform legislation often move through the decision making process rather slowly and implementation is delayed because of a lack of experience in interpreting the new laws.

5.3 Capital and Public Infrastructure

There is general consensus among economists that the lack of capital constrains economic transition to a market economy in Poland as well as in other Central and East European countries. Capital investments are necessary for a continued growth of newly founded private sector firms and for modernizing existing plants in the process of privatization. Without modern public infrastructure it will be difficult for a country to capitalize on whatever comparative advantage it may have. The public infrastructure is out-dated in many parts of Poland, and substantial investments in this area are crucial as well.

Many industrialized countries in the West, including the United States, as well as international donor agencies, support economic reconstruction in Central and East Europe. Yet, capital continues to constrain many investment projects, both public and private, and calls for a new "Marshall Plan" for Central and East Europe to meet the capital needs of the region can be heard periodically.

Although capital is undoubtedly constraining economic recovery in the short run, it appears that the importance of assistance in this regard by Western industrialized nations and by international donor agencies is frequently overrated. Loans and other forms of capital transfers can certainly facilitate improvements in public infrastructure and may help jump-start economic recovery. But the sheer volume of investment needs exceeds the volume of capital that is available for such purposes. Therefore, much of the capital needs will have to be satisfied by private investors from both within and outside Poland.

Regardless of its regional origin, sufficient private capital investments will only be made if the banking system is functioning appropriately, if investors can expect competitive rates of return, and if they can expect the political and economic outlook of a country to be one of stability rather than turmoil. This will tend to be the case only when economic reforms are successful and the political climate is stable.

5.4 Attitudes, Expectations, and Adjustment Costs

At times the success of reforms has been hampered also by a work force that seemed reluctant to react to market incentives and by a population that was rather pessimistic with regard to the success of reforms. But given the absence of experience with a market economy and the results of various types of economic reform under Communism one can not really expect such attitudes and expectations to change significantly without some evidence that market economic reforms actually improve the economy.

The typical worker in Poland and in other Central and East European countries is not a neoclassical economist. He or she has been working under the system of central planning, with a job virtually guaranteed and receiving a wage which was unresponsive to his or her own individual effort. Economic reforms under Communist governance sometimes tried to relate individual work effort to remuneration. But these attempts usually failed, generating the expectation in the work force that reform promises will not be kept. Hence, for workers to expect that individual effort actually is rewarded in a market economy, a sufficiently large number of workers will actually have to have had this experience. Workers will have to experience that poor performance results in unemployment or low incomes, and that individual effort will eventually be rewarded in the market place. And this, of course, takes some time.

The experience of Poland is a point in case. The Polish reform process started with price liberalization in the Fall of 1989. In Spring 1992 the economic decline had stopped and evidence of economic recovery became visible and by Fall 1992 the attitude of workers had begun to change and they began reacting to market incentives (Rapacki, 1993b).

The pessimism regarding the prospects of reform, which can be found frequently in Poland most countries in Central and East Europe has its roots in analogous experience. Attempts at economic reforms under central planning were numerous and they did not tend to improve the performance of the economy. With the exception of the small number of those who have been trained in neoclassical economics, the market economic reforms just appeared like any of the previous reforms under central planning. Hence, the expectation held by many was that market economic reforms are not likely to improve the standard of living either. This was aggravated by the economic decline that tends to accompany the economic transition due to partial reform, institutional arrangements which are inconsistent with a market economy, or other costs of adjustment. In fact, what people experience immediately as a consequence of market economic reform is economic decline and the individual costs of adjusting to the new system. Given their experience with past reforms, pessimism about the prospects of reform is widespread until clear signs of economic recovery become visible.

6. Conclusion

In this paper, we have discussed some of the variables which may constrain long-term economic recovery in Poland and other transition economies. Moreover, we have argued that (temporary) economic decline is difficult to avoid in the process of economic and political transformation.[12] Poland has chosen a strategy of reform that is now commonly referred to as economic shock therapy. The country went through a major decline in economic performance but it is now recovering at remarkable rates. Unlike many of its neighboring countries, attempts at economic and political stabilization have, by and large, been successful. This is an important precondition for keeping Polish capital in the country, for attracting private investors from abroad and for obtaining assistance from the international donor community. Much remains to be done, however, to assure that Poland remains on track toward sustainable economic prosperity.

Much like in the rest of the economy, putting in place the institutional arrangements for a market economy are crucial for agriculture as well. We can only mention a few areas here. The regulatory framework which would allow the evolution of an efficient banking sector in general remains suboptimal; the same is true for rural banking needs which often are different from

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[12]A nice discussion of the process of transformation can be found in Blanchard, et. al., 1991.

those of private sector firms in cities. Moreover, property rights have to be defined which allow the transformation of state farms and which would foster the evolution of an efficient agricultural sector (see also Stiglitz, 1993; Brooks, 1993).

A question that is frequently asked in one way or the other is: Should Poland follow the advice of Adam Smith or Friedrich List (Kowalski, 1993)? Here Adam Smith stands for a free market economy in which the government abstains from direct market intervention while Friedrich List stands for the institutions that govern the rules within which supply and demand are coordinated in a market economy. In our view, Poland should listen to both Smith and List equally, but in the early phase of reform it has listened a lot to Smith and not much to List.

Most agricultural economists believe that Polish agriculture has the potential to be internationally competitive. The general economic and political reforms in Poland should support the development of an internationally competitive agriculture. However, a necessary condition for realizing this potential is that the government abstains from pervasive agricultural market intervention and creates an economic environment in which farmers and agribusiness managers alike will find it attractive to acquire the skills necessary for success in a market-oriented agricultural sector.[13] This in turn requires building a national agricultural research system which is responsive to the needs of Polish agriculture and agribusiness enterprises.[14] This also requires an agricultural extension service which disseminates agricultural research results and helps feed back agricultural research needs to the scientific community.

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[13]For the appropriate role of government in the course of economic reform see also Stiglitz (1993) and Schuh (1993).

[14]Throughout the world researchers consistently find the social rates of return to agricultural research to be among the highest of public investments (e.g., Hayami and Ruttan, 1985).

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Figure 1: Partial and complete price reform on an agricultural commodity market

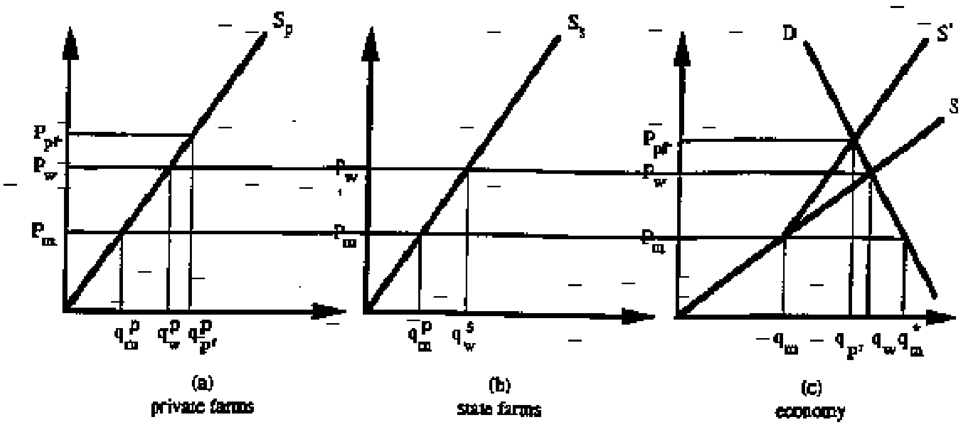

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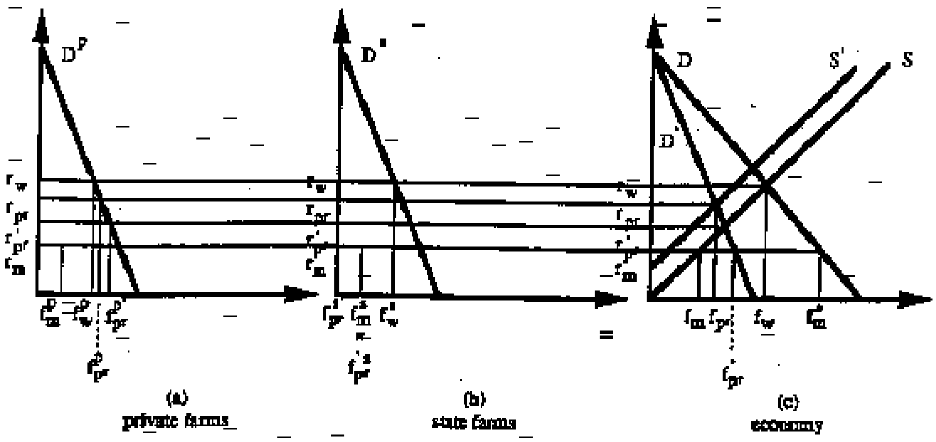
Figure 2: Partial and complete reform on an agricultural income market



r_{pr} = fertilizer sector must deliver to state farm at r_m

r'_{pr} = fertilizer sector can deliver to whoever

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