

As Poland's finance minister and deputy prime minister in the 1990s, Leszek Balcerowicz oversaw a sweeping program of economic reform. His shock therapy program ensured Poland's successful transition to the market.

Recalling his experience as the leader of Poland's market reform effort, the award-winning economist compares Poland's experience of reform with that of other countries.

Western Economic Thought and Socialism

INTERVIEWER: We spend a lot of time at the beginning of our series looking at the different ideas of the economists like Keynes and Hayek, and the battle of ideas between them. Sometimes we think of economics as a very academic profession. Just from your own personal experience, as an economist yourself, do economic ideas, these big ideas that Hayek and Keynes and Friedman had, do they actually matter? Do they end up affecting ordinary people's lives?

LESZEK BALCEROWICZ: Well, through intermediaries like journalists, like economists, I would say that Keynesian ideas have completely no application for solving the problems of socialism, because socialist problems are structural. And Hayek's ideas or Friedman's ideas, but especially Hayek's and [Ludwig] von Mises's, they were right. But when they put them forward in the '20s, in the '30s, they are being criticized by the mainstream of Western economists who then thought that Hayek was wrong, that socialists can be economically superior to a free market economy.

And I must say that when I graduated from what was called the Center of Planning and Statistics, only then I read this story, or what was called then the socialist efficiency debate calculation. I was struck by the level of absurdities as propagated by top-level Western economists, even in the '50s, in the '60s, because they constructed models which were very elegant. But they have only one weakness. They have assumed away all the complications of the real world and with this simplified model, they have declared a victory of socialism over capitalism. So since I studied the socialist economic system and knew that it was basically flawed because it deprived people of economic freedom, which is one of the other fundamental freedoms, private property, the right

to set up enterprise, I was really very, very surprised that in the West, most of the economists, who were technically very good, could propagate such absurdities for such a long time.

And against this background, people like Hayek or von Mises or then Friedman, but especially Hayek and von Mises, came to me as people who were not mistaken, who could recognize problems early on before they really emerged. And there were some other people, like for example, a Lithuanian economist who wrote in the early '20s. He has pointed out all the problems which actually appeared in the real life of socialism. So there were economists and economists, and much of the economics profession was wrong in the West.

INTERVIEWER: Why did they get it so wrong?

LESZEK BALCEROWICZ: I think because of a certain bias in the economics profession in the West, which has been corrected, since, let's say, during the last 20 years. They went for technical models, but to build a good mathematical model you have to abstract from some aspects of reality, and it so happened that what they had assumed a way there were real complications that people differ in their propensity to take risk, that central planners cannot have complete information, that individuals are individually motivated, self-centered motivation. So you cannot count that they would be blindly following instructions of a great herdsman. And in the late 1970s I remember meeting a prominent British economist, a lady, Joan Robinson, and she came to Poland, and she was praising Mao's China. Mao's China she was praising. Perhaps she was in China [for] one day or two, but to us, at least some of us, living in Poland, which we knew was not being in China but more or less what socialism can mean to the people, it was like a great abrasion.

The Functioning of the Soviet Economy

INTERVIEWER: Now, with time passing, I think often people don't understand or don't remember what it was like under communism, how the system actually functioned. In the film, we spend a lot of time explaining the Soviet economic model, but could you

just explain generally how the Soviet economic model was grafted, or to what extent it was imposed upon the Polish economy?

LESZEK BALCEROWICZ: Well, the basic Soviet economic model, or central planned economy, was imposed on every country which was politically dependent on the Soviet Union. It was the same basic structure. It was a very simple structure. The first step was to deprive people of economic freedom. Once you deprive people of economic freedom, then certain decisions have started to be taken: what to produce, the decision about prices, where to invest, how to coordinate economic activity. Now, if economic freedom is abolished, then the market is abolished, because market mechanism is the mechanism of coordination of free people. So then there is a vacuum which has to be filled in, and the vacuum is filled in by a huge bureaucracy. And then you have a huge bureaucracy, and once you have a huge bureaucracy, then you have all the weaknesses which are related to huge bureaucracy at the country level: that people are lying to each other; that subordinates are trying, since they are giving targets from their superiors, to lie to the superiors about the possibilities so that they are rewarded for fulfilling or over-fulfilling a rather easy plan.

And then the money—you can't have a real money, meaning something which is a perfect substitute for goods and which is convertible, because convertible money is a piece of freedom, and it is incompatible with communism or socialism, which is an anti-liberal regime. So worthless money was a fundamental part and aspect of this system. And then wrong incentives, because there was no competition, no freedom of entry, and within this bureaucratic hierarchy, as I mentioned, there were incentives to lie. So subordinates, since they were assessed by fulfilment and over-fulfilment of the plan, their whole energy [was] spent on what? They spent on lying to their superiors about the possibilities. To some extent, the same happens within the budgetary planning in the West, because the budget is a piece of central planning. So the less of it you have, the less scope for pathologists related to bureaucracy.

Gorbachev and Gaidar: The Russian Reformers

INTERVIEWER: In the mid- to late 1980s Gorbachev had begun perestroika, his attempt to reform the system there. Of course you had solidarity here, martial law. Did

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you feel at the time that what Gorbachev was trying in the Soviet Union was likely to succeed, and indeed offered hope for Poland?

LESZEK BALCEROWICZ: Perhaps at this point I should [say] a few words about myself. When I was a student of economy, to some extent by chance, because I was attracted to the name of the Faculty of Foreign Trade, because it promised something which was very scarce under communism—traveling and seeing the world—and then I ran into Western literature. I got my MBA from St. John's University in New York, and I was also attracted to basic questions of political economy. What makes some countries rich and other countries poor? It is Adam Smith's question. And I came to the problem of reforms and thought that once you try to introduce as much market as possible, then the constraints of the existing political and geopolitical order [can be lifted]. I created a group of then-young economists, and from '97 through '98 we worked informally.

We wanted to be realistic, to [have] at least 1 percent realism, so we assumed that the Soviet Union would exist. Nobody was assuming otherwise at the time that it is not possible to have full-fledged democracy. But we thought at least more market, like in then-existing Yugoslavia, and we were working for two years systematically, and when first Solidarity came into being we were ready with a blueprint for a sort of market socialism. I myself was not for market socialism as the best solution, but under then-existing constraints, it seemed to be the best solution. But then martial law was introduced in Poland, and for us it meant that hopes to persuade authorities to reform have to be abandoned. And then we went full steam. I went full steam into devising a system which could be introduced and would be the best from the economic point of view, if Poland were free.

We were not assuming that Poland would be free in 1989, but it was an interesting question, and we were ready. I was ready, I think in early 1989. Gorbachev, when he came, I thought that—and I still think that—Gorbachev's idea was to modernize the basic Soviet-type economic system. He was not thinking about legalizing private ownership, which is the basic, but introducing currency and convertibility. He rather thought that through improvements in basically the same mechanism one can achieve better economic results. His achievement or his contribution was, I confess, a full

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glasnost, transparency, glasnost because he let people speak, and in this way he set in motion a mechanism of destruction of every system. I don't think this was his intention to go all the way. But his great contribution to history is that he did not try to stop it, to use force to stop the process of undermining and destroying a very bad system from the point of view of human rights, human well-being. And in this way he made the creation of a better system possible, a better system for the people.

INTERVIEWER: Talk about when you met Gorbachev.

LESZEK BALCEROWICZ: I remember, I met Gorbachev several times, but once in a very interesting moment—it was August 1991—I was then the deputy prime minister and minister of finance of Poland. I was invited by the Soviet government before, but then you had the coup, and he was just released and free. And I decided to go ahead, and I remember the conversation with him, and he seemed to me that he was still optimistic about the future of the Soviet Union. He struck me as a rather optimistic man, and he invited me to come at a later date to talk about economic plans for the Soviet Union, and indeed I came at the end.

It was in December 1991, but my main partner then was Yeltsin, Yeltsin and Gaidar. These were my last days of my public service in the Polish government. I went for some talks. Russia was about to launch economic reforms, and I talked with Gaidar first. And we were good friends because we knew each other before, and Poland was the pioneer, to some extent, a model. I remember the conversation with Yeltsin, and I read he was a bit less optimistic about the pace of improvement than Gaidar. At the same time, he said that he would offer any job for me if I stay in Russia, but I have chosen Poland, but I have been following Russian developments very carefully.

INTERVIEWER: At the time, was Gaidar nervous? It was just on the eve of launching the reforms there. What was his mood?

LESZEK BALCEROWICZ: No, I don't think he was nervous. He was very focused, concentrated. He knew that it was a very important reform, perhaps more difficult in Russia than in Poland, to launch price liberalization, to dismantle the machinery of

central planning, but I think he was concentrated on the job, and we talked like colleagues. I remember it was very informal. There was a government delegation, but it was very informal. We were eating sandwiches, not any elegant banquet or dinner. It was kind of a very working-type arrangement.

The Unpopularity of Reformers

INTERVIEWER: [Gaidar] mentioned when we interviewed him that during one of your conversations together, you had said to him something to the effect that wouldn't you do this when you tried this new version of shock therapy. "Many people will attack you, and you may even become the most hated person in Russia," he said, "but you must do it; it is the right thing." He laughed, and said, well, that's in fact what happened. Do you remember that?

LESZEK BALCEROWICZ: I think so, but I think it is a part of the job, that things which are very important to people and are fundamentally positive for their lives often meet resistance. And a reformer, if he or she is successful, has to take this risk into account and be ready to shoulder it. Of course she or he should be trying to publicize, to communicate with the public, but if you start at the very difficult situation, you don't have a lot of time to communicate because it is like fire. You have to put out the fire, and it is better to be quick and give up some additional amount of persuasion than to delay your rescue operation. And even the most successful reforms produce under satisfaction, and one has to know it, for example, because certain problems, which were hidden, came into the open.

Under communism or socialism, there was huge unemployment, but it was a disguised unemployment. People usually prefer unemployment on the job from open unemployment. But it is open unemployment; it is bad for economic growth and for the future prospects for the people. So disclosing it creates the possibility of solving it, but it takes time. So one reason is that successful reforms make hidden problems [come out] into the open, and in this way it is possible to find solutions about this cause. Second, under the centrally planned economy, you have a special hierarchy of ranking of pay and prestige. For example, miners were at the top, a large group, because socialism, or communism, was a very wasteful system. This system needed huge

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amounts of energy and raw materials because it wasted them. So people who worked in extracting resources and energy had to be paid relatively well, compared to other people or to some professions, which in fact were not very necessary, like marketing men.

Under [a] shortage economy, you do not need much marketing to sell, because there are problems of buying. Now, what happens once you made successful economic reforms? There are changes in the relative hierarchy or ranking of pay and prestige and groups which were at the top. Let's say miners are going down in relative terms, not necessarily in absolute terms. And at the same time, there are other groups which are going to the top, like bankers, lawyers, information technologists, specialist accountants. Now, these second groups, which are gaining in relative terms, are satisfied usually, but are so busy with their new jobs that they are not active politically as they should. Why those relative losers—I am stressing the word "relative" because in absolute terms they are better off as compared to socialism—but in relative terms they are losing, and usually they cannot be happy. But this is one of the reasons why even the most successful reforms produce some dissatisfaction. So it is completely unrealistic to expect that successful economic reforms must make everybody happy. It is impossible.

INTERVIEWER: What's it like to live through that, when you are in government and are being attacked for unemployment? It must be personally sort of stressful to be attacked.

LESZEK BALCEROWICZ: But it is a voluntary job. If one accepts a job voluntarily, then there is no right to complain. One has to calculate, to take into account. In my case I knew that the job was extremely important, because in Poland a *raison d'etre* is to be economically successful, because without that you cannot solve many other problems in Poland, including problems of foreign policy. So I was motivated by the importance of the job, and also since I studied experiences of other countries and reformers, I knew that one has to accept in advance some unpopularity as a price for solving the country's problems, of putting a country on a better path. I remember being in Britain

in the '80s, and I knew that Mrs. Thatcher was not popular with every group, but I think she made a great contribution to solving Britain's problems.

INTERVIEWER: Was she an inspiration for you?

LESZEK BALCEROWICZ: Not intellectually, because intellectually I'd been thinking before of what to do, and the size of Polish problems was much larger than the size of British problems to be solved by Mrs. Thatcher. We have 90 percent of the state enterprises in the state hands. We have the machinery of central planning. We have nonconvertible and weak money. So our problems were much broader, larger than British ones, or problems which were faced by [former Chancellor] Ludwig Erhard in 1948 in Germany. He had a very easy job compared to the job of reformers in the former communist economies, but I think he was an inspiration as far as character is concerned, that one has to be persistent, and she knew she had to fight her way within the Conservative Party, which was paternalistic and abandoned classical liberalism.

The Lessons of Latin American Reform

INTERVIEWER: I just wanted to touch briefly on other inspirations. Latin America, of course, had their own debt crisis at the time. Jeffrey Sachs went over and advised Bolivia. Did the experience down there have any impact on your thinking?

LESZEK BALCEROWICZ: Well, I studied experiences of Latin America's stabilization before 1989, because I was interested in the experiences of various countries, and this was useful, because in Poland, the starting conditions were more difficult than ones that existed in, say, former Czechoslovakia or in Hungary. In Poland, we had some Latin American problems like high inflation, plus typical problems of socialist economies, structural problems. Studying macroeconomic stabilization was useful, and one lesson which I have drawn from various studies was that it's absolutely essential that first attempt is successful, because every next attempt would cost more, would be socially more costly.

One has to establish credibility. One has to be tough on stabilization, and being tough is good for the people, in a way because it reduces the risk of a failure of another

attempt. And I was impressed, in a negative sense, by various successive failed stabilization programs of, let's say, Argentina, and I knew how costly it was. So this part of the Latin American experience was useful, and various technical studies, what should be the stabilization programs, what nominal programs one should use. And I thought that from this point of view, from the point of stabilization of a socialist economy, what we had at the beginning is not basically different from, let's say, Latin American economies, or the classical instrument will have to be used: first of all, a radical reduction of the budget deficit, tightening monetary policy, and one specific type, I should add, because I thought that if you had a state-dominated economy, if state enterprises are dominating, then there is no counterweight to the influence of the workers, and the wage setting becomes inflationary, and this is where I argue for ... a control on wages. This was a Polish contribution to stabilization. We have studied it much before, but once you have a private economy, then natural forces started to operate, and it is in the interest of the owners and managers to resist excessive wage pressures, and also private enterprises are more productive so that they can offer more reasonable real wage increases.

Balcerowicz as Poland's Erhard, and Jeffrey Sachs's Influence on Polish Reform

INTERVIEWER: When Jeffrey Sachs was invited to come over at the height of the Round Table talks, how influential was he in persuading the leadership of Solidarity to consider a radical economic reform?

LESZEK BALCEROWICZ: I think Jeff Sachs played a very important role in Poland in persuading those who needed persuasion. Not everybody was persuaded that the best way was a radical transition to a free-market economy. As far as I was concerned, I was convinced from my earliest studies.... He was invited to the meeting of the then-existing Solidarity club, and he made a very good impression. At that time, I was preparing myself to leave for Britain, because I was invited as visiting professor to one of the British universities. And then all of a sudden I was invited by Prime Minister-elect Tadeusz Mazowiecki when he offered me this job, which I first rejected because I knew that the task was daunting, but then after a second conversation, after a sleepless night, I said okay, yes.

INTERVIEWER: Why did you reject it?

LESZEK BALCEROWICZ: Well, because I knew the task was very difficult, and I had some hesitation. I knew what the required price would be. I had a family; I knew that it also would be a problem for my wife and the children. And I was not planning a political career before, because I didn't want to have a political career under the former system. But then, after talking to my friends, and also after thinking it through, I came to the conclusion that the problem which Poland has, this problem I have been studying all my life at the university, was how to get people on the path of rapid and sustained economic growth to catch up once Poland became free. And if I had rejected it, then perhaps to the end of my life I would have some doubts.

After these sorts of considerations and talks I accepted it, and one additional thing which persuaded me to accept is that I have a group of people. [As] I mentioned, I worked with a group of people in the late '70s, and we continued throughout the '80s. And these were relatively young people in the range of 40s or [younger], so I was not alone. We formed a sort of economic part of the government, and we were usually quicker than the other part in proposing solutions, and then we took over the job of getting the acceptance. Within the Parliament, I have some excellent partners. My former student, for example, became sort of my chief of staff, and he was entrusted with the job of political coordination, how to get the support within the Parliament, and we set a deadline.

I started in September '89, and I had to deal with the current problems of current imbalances dealing with Western creditors. Poland was a bankrupt country preparing two successful budgets for the rest of the year, talking to the IMF and World Bank while at the same time working out the basic program, which had to start on the first of January of 1990. And this was a package of 11 fundamental bills which had to be accepted by the Parliament within three weeks. So we had to prepare the ground for that special mechanism, special commission working parallel. The Senate and the Lower House had to work, but we had to come out with the ideas about how to do it and to create a special atmosphere. I think deadlines can make wonders, but you need pressure.

You feel pressure in the case of deadlines, but without pressure, I think it will take a much longer time, and I am not quite sure that quality would be better. Probably quality would be worse. Sometimes you have to work under pressure and put pressure on other people. So coming back to your question, one important reason why I finally accepted it was that I have a group of people, excellent people, who entered some key positions in the government, and with that group, I could count on success, even though I knew the risk was huge.

INTERVIEWER: Just picking up on the conversation you had with the prime minister-elect, I think I read that he had said to you when he was trying to persuade you that "I need an Erhard." Is that true?

LESZEK BALCEROWICZ: Well, I remember the first meeting with Tadeusz Mazowiecki, the prime minister-elect, and he really said that, that he needed his Ludwig Erhard; that he wanted somebody who would be the deputy prime minister and at the same time the minister of finance. I think by that he meant that he needed somebody who would take charge, take responsibility both for stabilization and structural reforms. And I thought, "This is a good arrangement," but during the first conversation I was not ready to accept this responsibility, knowing how daunting is the task.

It so happened that I have studied Ludwig Erhard's experience before, [when] I was a visiting scholar in West Germany in Marburg, where I had friends at Marburg University, I studied Ludwig Erhard's economic program of 1948, and I knew that it had limited applicability to a socialist economy. Ludwig Erhard had only to remove the constraints of the war economy. I think that the system he inherited could be called a suspended capitalism. Capitalism was suspended, meaning free market was suspended because of the machinery of war economy, which was a bit dissimilar to a central planned economy but was transitional. So you had just from one day to another to remove it, and these were *Beseitigung* or *Bewirtschaftung Vorschriften* in German. Very easy. ... He had to stabilize the money by monetary reform. That's it. Erhard did not need to privatize, because private institutions, private ownership were not destroyed. He didn't need to restore or to create a stock exchange, because it was not destroyed. He did not need to create the banks, because they were not destroyed.

So his starting situation was much easier. The starting situation, or the amount of a job to be done under any reformer who inherited a socialist economy [was less]. And I called this starting condition "destroyed capitalism" as distinct from "suspended." So basically there is more to be done. First, stabilization and the job of stabilization differ depending on the country. In Poland, it was huge, because we inherited hyperinflation and massive shortages. In the former Czechoslovakia, it was easy because it was a relatively stable economy. Second, liberalization, or in other words removing constraints on economic freedom, removing the machinery of central planning, was a huge job in every socialist economy. But third, and this was the specificity of post-communism, post-socialist economic transformation, was to recreate, to start from scratch, with building of market-type institutions. The Central Bank did not exist. You had to have a mono-bank. The stock exchange could not exist. It was anathema, because it was right to regard it as a core of capitalism, and capitalism was bad by definition. Then [there was] public administration, which was not used and not structured in such a way as to be competent in dealing with problems of a market economy. So the third part of the job, which I would call institutional restructuring, was huge. This is the specificity of a post-socialist reform, and this is good, a massive amount of privatization, because of a massive amount of an inherited state sector.

INTERVIEWER: Let me just talk to you about Jeffrey Sachs. When he was here, did you feel a certain affinity with him, and how closely did you work together, and to what extent did his ideas influence yours?

LESZEK BALCEROWICZ: Well, I think we arrived independently at certain basic solutions, and this is why we were close, because there was a closeness of independently discovered ideas. And I really appreciate the help Jeff Sachs has given us, especially with respect to the reduction of foreign debt, because he made a case for it in the West, especially in the United States. But I also remember his good colleague David Lipton. They came together. David Lipton later entered the Clinton administration, and he was very helpful, too. And there were some other advisors, some of them of Polish origin like Stanislaw Gomulka, who worked at the London School of Economics, and he came to Poland. [There was also] Jacek Rostowski, who was of Polish origin who was born in Britain, but he spoke perfect Polish and was a very

good economist. So I think that I had a core group of excellent advisors who helped us on working out some legal strategies in the program.

INTERVIEWER: Sometimes when you read short journalistic accounts of what happened during that timeframe, they say that Sachs brought his program to Poland, and Poland adopted the Sachs program. Was that accurate?

LESZEK BALCEROWICZ: Well, as I mentioned, I think we worked on the Polish program in Poland for 12 years before it was actually launched. We were arriving at successive solutions, and I think such directions as privatization, convertibility of currency, stabilization, they were worked out here. But it was very helpful to have confirmation from outside, and also some additional crucial details like, as I mentioned, debt reduction, or the crucial detail of the stabilization program. And it made us more confident that people from abroad like Jeff Sachs, like David Lipton, like Jacek Rostowski or Stanislaw Gomulka, were working with us, because as I said, I was absolutely sure that going slowly would condemn us to failure, but that radical option is risky. [But] that is better than hopeless. It is risky, so to have outside advisors who were helping with working out crucial details was also psychologically important.

The Economist Becomes a Politician

INTERVIEWER: You were an academic, an economist. Suddenly you were operating in a very political environment. How did you know what to do?

LESZEK BALCEROWICZ: Well, there are two things. First, what to do in the sense of what sort of economic model one wants to create for Poland and how to make a transition? For me this was the basic task, and years of working on that with colleagues was very useful, because we did not have to learn on the job. This is very costly to the people if somebody is learning on the job, an important job, and perhaps in this respect, Poland was different from some other countries. We had, I could see very clearly, the target system and the transition. About the target system I knew that it had to be most conducive to economic growth, to catching up. And this could be defined in more concrete terms, that you have to have private ownership, stable money, sound public finance and unbureaucratic regulation of businesses, etc.

About [the] transition, I was determined that the first phase had to be very fast and very comprehensive. On that I was totally convinced, because first I studied the nature of the communist system, and I knew that you cannot reform it by small steps. It is against the logic of the system. The first leap has to be very great.

The second argument was political. I suspect that I sensed that just after breakthrough, there is a short period, which I named the period of extraordinary politics. By definition, people are ready to accept more radical solutions because they are pretty euphoric of freshly regained freedom. The Communist Party was discredited, so it did not form the opposition, and some of the members cooperated because they understood the necessity of free-market reforms. And the democratic opposition, which in Poland was larger than in other countries, did not yet quarrel. So this was a gift of history, and I thought one could use it only in one way, by moving forward very, very quickly. Moving forward under the special condition was a substitute for having a very strong political party. ... Speed was of the essence.

And third, in my studies, before I was very much interested in economics, [I was also interested] in psychology, and I knew from the study of social psychology the theory of cognitive dissonance of Leon Festinger, and I knew that people, in order to be convinced that something is to be inevitable, they need a large amount of change. So even if they do not like it, once they became convinced it is not reversible, they would have to adjust. So I had these three arguments—economic, political, and psychological—that strengthened me and convinced me that the reform has to be very radical if it is to succeed.

INTERVIEWER: Were you working long hours?

LESZEK BALCEROWICZ: Well, I had a rule to not work more than 13 hours per day, because I think being an economist I have to calculate a long-run marginal productivity. (laughs) And I had some colleagues who worked longer hours—15 hours, 16 hours—and I think it was very unproductive and unhealthy. You could not read all the amount of papers you have. So my first assumption was I would not read everything; I will focus on those which are strategic. Second, and this is in every large

organization, you have very important decisions, personal decisions, about with whom you work and [whether] you could trust them or not, trust his character and his competence. I think I was lucky in my first choice of my partners, my colleagues. I was sort of a leader of an economic team within the government, and as I mentioned before I had created a group in the late '70s. And some members of the group worked with me as academics, but very practical-oriented academics, and in the '80s they entered the government. For example, Marek Dabrowski was one of the members of the original group which I created in 1978, and then he entered the government with me as my deputy in the Ministry of Finance, which was crucial. The minister of finance became very powerful in Poland, and rightly so, as a center of stabilization and structural reforms. And there were also some other people with me, like Jerzy Kozminski, who was my former student; he was a sort of political coordinator, and he did an excellent job. Then he became later Polish ambassador to NATO and did a tremendous job in the United States, too, by convincing Americans, both Republican and Democrats, that Poland's entry to NATO is a good thing for NATO and for the United States.

First Days of Shock Therapy

INTERVIEWER: Let me ask you: On January 1, 1990, what was going through your mind that day and the days that followed? What were the first signs you had that things were changing? I've heard stories about "Look at the price of eggs"

LESZEK BALCEROWICZ: That's right. First, I did not have a blind faith in the success, but my determination was based on more intellectual fundamentals. ... People who were making the decisions for Poland, like myself at that time, either we go slowly, which would delay change—and this for me was a completely hopeless option, no possibility for success—or we go very rapidly because of the economic, political, and psychological argument, and this option was only very risky because of the amount of uncertainty. But a very risky option is much superior to the hopeless option.

So I rejected [going slowly]. I knew that if we go slowly we are condemned to failure, like let's say Belarus or Romania. Every country which went slowly went down. But I also knew that if we chose the right option, we may fail, because of the amount of

uncertainty or if we give in to pressures. This is why I was so determined to persist, because I knew that the dangers, the real dangers, appear later. So in a way I knew that we made the right choice, that there is no better option. But I also knew that there was a risk, and we were looking for signs that the program was working, and various parts of the program have various maturities, so to say, because solutions have various maturity. For example, shortages. I always believed the shortages could be removed very quickly once you liberalized and removed rigidities of the supply side and the price formation perhaps, introduced some macroeconomic stabilization—and it worked.

And along the way we have settled a controversy, because there was a raging controversy in the literature over what the reasons for shortages were. I remember a famous Hungarian economist Janos Kornai, who has written a well-known book *Under Equilibrium*, and he was maintaining the main reason for shortages was what was called "soft budget constraint." I thought he was wrong. I thought that the main reason for shortages was rigidities. When you have uncertain demand, fluctuating demand and rigid supply and price, you get shortages. My plan was based on the assumption that rigidities are the main reason for shortages, and this is why liberalization or removing rigidities is the necessary and sufficient solution. And it worked. And we looked for price stabilization. I mentioned that we Poles inherited huge inflation, and it was uncertain how quickly it would fall, but it started to fall, to decline. There was some revival in the second part of the year, which was a disappointment, but basically, price stabilization worked.

Then another problem was that Poland was a bankrupt country, and we could not service the debt. This is why a very important part of the overall strategy was to try to get the debt reduction. And my approach was as follows: that on the one hand I have pulled down what Poland is going to do—radical reforms, radical stabilization. On the other hand, there were some expectations with respect to our Western partners. And by far the most important expectation was debt reduction, and I must say that Jeff Sachs was very helpful in this respect by propagating the case for debt reduction for Poland.

So when I first came as a new minister of finance, the deputy prime minister—that was the second week of my being in office—I met my colleagues from Western countries, which were Poland's creditors, and presented them with this short paper, "Poland's Approach," [about] what we are going to do, what would be our expectations. I sensed a certain disbelief that Poland would do what we are actually saying we were going to do. And I think for some this changed to respect for Poland, that Poland is actually doing what was considered right but difficult. And the amount of support for debt reduction and for other things was growing with Poland's determination to reform, to do tough economic reforms, which were good, which were necessary for Poland. We are not doing them for the West; we are doing them for ourselves.

INTERVIEWER: On those first few days, those first couple of weeks, how did you know that things were working? I mean, were you going around to markets looking at the price of eggs?

LESZEK BALCEROWICZ: Well, yes, we did some direct empirical studies about how the program was working. ... I like to exercise. I was going for a walk, usually with some of my younger colleagues so that I can walk fast enough, and we were looking at the prices and supply in the shops. And I had this special working group, too, which were collecting data, including information about the prices of eggs. And I remember that very important day when they said, "The price of eggs is falling." This was one of the signals that the stabilization program is working.

A Comparison of Polish and Russian Reform

INTERVIEWER: Around that time we also interviewed Grigory Yavlinsky, and he was here, watching what you were doing and trying to send memos back to Gorbachev. But the Soviet ambassador here would not let him send telegrams, and then he had to go over his head. Did you feel as if the Soviet leadership was closely watching what was happening here?

LESZEK BALCEROWICZ: Well, I was so focused, so concerned with Poland at that time that I was not following very closely Russian, or then Soviet, developments. But I knew that at least younger members of the team were following Poland's developments very

closely, because for them it was a natural experiment; by reforming Poland, we were giving other countries the possibility to learn from our experiences, including our mistakes and achievements. So I knew that the younger people of the team were in Poland. I remember meeting them in Poland, talking about Poland's economic reforms, and I had the impression that we were in basic agreement about the same philosophy, first, with respect to the target system, what sort of economic system you want as a result of transition; and second, about the strategy of transition, about speed and radical nature of the first phase. This is my impression, which I have from after so many years.

INTERVIEWER: Now with hindsight, you look at the Polish experience of reform as compared to the Russian experience. Many people say that Poland was generally a success where in Russia, the success, if there was some, was not so great, and it created a distorted kind of capitalism, a particularly Russian kind of capitalism. What is your view of what the main differences were in the way reform was tried in Russia as compared to Poland, and why didn't it perhaps succeed as well as it did here?

LESZEK BALCEROWICZ: Well, I think the same basic approach applies both to Poland and Russia and Romania and Ukraine. I am against the argument that there are such specificities in some countries that you need a completely different approach, like with the case of Brazil. Brazil was different; Brazil had to apply classical solutions to be successful. So I think that the same best treatments [should be used] for certain economic diseases. Like if you want to remove shortages you have to liberalize. If your problem is high inflation, you have to do macroeconomic stabilization and have some technical discussions, but basic directions are clear. If you have inefficiencies because of a state ownership you have to privatize. If the banks are unhealthy, then they either are politicized, being state-owned, or being private but closely linked with political authorities, like in South Korea. You may have private banks, but still politicized. So arm's-length privatization solution—it's the same approach.

I think specifics in itself do not matter so much. You may have two people, a Chinese man and a Russian, but if both suffer from tuberculosis you would not say because one is Chinese you need a special medicine. The mere fact of a specificity does not

necessarily call for specific treatment. And the same goes for Poland and Russia. I think this should have been a similar approach, the same direction. In the Polish case, for some reasons we are able to maintain the implementation of a program for a longer time.

My first period in the government was 800 days. Basically [I worked with] the same team over two years, and during that time we managed to stabilize, move shortages to the bulk of liberalization to prepare the foundation for the capital market, stock exchange, privatization; to make currency convertible; to strengthen the independence of the Central Bank; to build the basic social safety net in which we made some mistakes, but the mere existence [of it] was important. [There were] some other things, because we managed somehow in Poland to be in office with a package of radical reforms for over two years.

In Russia, for political reasons, reformers were not given the same amount of chance. So only after half a year, there were disruptions in the economic program, especially on the fiscal side and on the monetary side. So the stabilization effort was not given a chance, and this is the main reason why Russia is less successful than Poland. One has to look for political underpinnings of economic policy and perhaps the role of personalities, because economically speaking, Russia's starting conditions were not very difficult. There were possibilities for improvement. For example, the fact that Russia had a huge military sector created conditions for reducing this sector, and then spending more on some other issues. So something which is a liability may be an asset, because you may make some reduction and improvement.

Perhaps paradoxically, Russia's true liability was huge natural resources—natural gas and oil, because they poisoned. It created such strong temptations in the privatization process that they had to some extent poisoned this process. We did not have such huge natural resources. So this is one of Russia's specificities. Another is unstable politics.

And the third and related fact is the following one: What for Polish people or for the Czech people, for the Slovak people, for the Hungarian people was a liberation from

Soviet oppression, for the Russians, it could mean loss of prestige, the different psychological atmosphere. I am not blaming Russian people, because they were victims of the system, but I am saying that some of them had derived some satisfaction from the fact that they belonged to the superpower. They counted nonmaterial, non-economic satisfaction, and all of a sudden it collapses. For Poland, it was, as I said, liberation, euphoria; we became free. The Russian people could not have, I think, the same feelings, at least some of them, because they lost prestige. I know that many intellectuals in Russia were supporting this change, but ordinary men probably had different impressions. My main point would be that the psychological climate in a country like Poland was better during the first phase than the psychological climate in Russia.

INTERVIEWER: What role does culture play in history, of having some experience with capitalism and free market?

LESZEK BALCEROWICZ: I think the role of culture is widely exaggerated, and it is a sort of easy theory to explain. I think that one should look to hard facts first, and the hard facts are what are your starting conditions, especially economic. Then economic policy: Is a tried economic policy wrong? Some geographical factors may play a certain role. But as a last resort one should look to so-called cultural factors, because they are so difficult to define and so easy to try to explain successes or failures of transition in terms of special culture, and I was always very doubtful about it.

I remember when South Korea was a success everybody was saying, "This is because of the special culture," but I said: "Look, you've got North Korea. You have the same culture, and it pervades in North Korea." So what does it show, that by far more [there are] important factors—economic policy, institutional structures, reforms. What is the framework for people's activities, including economic activity? So I think cultural factors first should be precisely defined and then used as explanations [as] a last resort, having exhausted explanations in terms of economic policy, determinance of economic policy, amount of external shocks, etc.

Economic Systems Throughout the 20th Century

INTERVIEWER: Let me just ask you generally: Today we see demonstrations at IMF and World Bank meetings, and people like Vaclav Havel and Kofi Annan saying that capitalism has to have a moral element. As somebody who played a part of the history of your country, and indeed a part in a big historical global change from state control to capitalism in many different countries, different experiences, do you feel like in a way the pendulum is swinging back the other way? Is the trend continuing or not?

LESZEK BALCEROWICZ: First of all, one should remember that the word "capitalism" was devised by the enemies of free markets, so it sounds bad to many people. Second, Western intellectuals, especially in France, were blind to the evidence of totalitarianism and communism in China, in Russia, and they should say it openly. It is so easy to preach, to say. But I think the true value lies in facts, and the facts are as follows: that the systems which deprive people of economic freedom condemn people to parrot it, and also condemn people to dishonesty because the central planning system was based on cheating, on connections, there was a built-in inequality. It was hostile to the work ethic, so it was bad both from an economic point of view and from the moral point of view. It cannot be defended on either of these grounds.

Now, if you take intermediate systems—let's say you have got private ownership but a lot of state redistribution, a welfare state. Now, some forms and sizes of the welfare state hamper job creation, so then you condemn people through wrong economic policy to unemployment. Unemployed people cannot live dignified lives, and also dangerous is long-term unemployment. Long-term unemployment is dangerous to people's families. So some "social policies" are antisocial, if they lead to rigidities and situations in public finance which then create unemployment. And third, a state presence in the economy, if the state is an owner or a detailed regulator, creates opportunities for corruption or for politicized decision-making. We witnessed this in France, with the Credit Lyonnais Bank; we witnessed this in some Asian tigers....

First of all, by creating the frameworks for people's security—law and order and creating good laws and implementing these and defending the country, etc.—by focusing the state on these, one creates pre-conditions both for economic well-being

and a potentially better moral climate, because one reduces the temptations and the dangers. But there are always intellectuals who are looking for something, which is different, where they lost a cause. Some of these intellectuals were defending the Soviet Union. Now, the Soviet Union did disappear, but some of them were against American missiles being installed in West Germany once Soviet missiles were restored. Now, for some people—and usually they are people from better-off families; they are not from workers' families—that is sort of a pet fashion or a hobby.

Let's look at the history of the West, or even of the world history from the economic point of view or institutional point of view. What you see the last 100 years, at the turn of the 19th and 20th century, we have a liberal state. There was a globalization then. The movement of people was freer than now; movement of capital was massive. Globalization is not a new thing, except for information technology. Then, for some reason, you got communism, fascism, and this is a good part, unfortunately, of the 20th century. And also in the West, there was a certain statist tendency after the second world war, to some extent influenced by what was wrongly perceived as the successes of communism. And this was expressed in expansion of the state as owner, and in fiscal expansion, welfare state, deficits, and toleration of deficits.

But then since the late '70s, you have a reversal, which I think you have got because of the painful experience that state enterprises cannot be efficient in the West, that they breed clientelism and corruption. But if you pass a certain threshold as far as expenditures are concerned, then taxes are high, and this creates unemployment. Then rigid labor markets are bad because young people cannot find a job. Then fiscal deficits lead to tough monetary policies. So you have a new paradigm, and a new paradigm is against back-to-the-basics. Of course it is clouded, or it is formulated in various words. It is different under France socialism. They would never say, "We are going back to a free-market economy"; they would never say, "We are building an Anglo-Saxon model." But in fact they are doing that.

But everywhere, I think, you have a tendency to return to the classical paradigm, with certain additions because of new technology, and I think this is a positive development, because the previous development, for excessive amount of state intervention, was

bad for the people, bad from the economic point of view and bad for the moral point of view.

Solidarity Feels Betrayed by the Reform

INTERVIEWER: We are going to film at the Ursus Tractor Factory, and also going to Gdansk later in the week. But already in the research we have talked to workers there, many of whom feel in a way betrayed by the economic reforms that your government was involved in, and since you were part of a Solidarity-led government, they feel that in a way that you betrayed Solidarity. How do you react to that?

LESZEK BALCEROWICZ: Psychologically one can understand these feelings, and they are due to the fact that Solidarity did not have a right economic program. Solidarity was first of all about getting from the then-communist authority the approval for legal existence of a trade union Solidarity. But on the economic front, they insisted on fully fledged wage indexation, and they had the illusion that perhaps they were not giving enough thinking to what would actually happen once they govern. And they were not ready or completely prepared to form the government. So once this opportunity appeared, there was a surge for somebody who would take the responsibility for economic program, and it so happened that I was offered this. I was approached, and I accepted, but it was obvious to me—and this was one of the reasons for my hesitation—that one has to disillusion people who believed that through wage indexation, one can solve the problem of hyperinflation. Quite the reverse was true. One has to abolish it.

So subjective feelings of the workers are understandable, but they could not form the basis for economic policy. One should remember that in Poland there was a special atmosphere, that to some extent the Marxist utopia came true, but against communism, the working class became a collective hero, a collective hero in abolishing the system, which officially declared the supremacy of the proletariat, of the working class. This was the irony of history, but some of the workers maybe were thinking that then you would have a system with a prominent political role of the workers, or a Third Way solution like labor-managed enterprises.

Now for me, when I was working in 1978, labor-managed enterprises were the best solution because of geopolitical constraints. I would go for privatization full steam if not for the existence of the Soviet Union. But once Poland became free, I was absolutely determined that we cannot adopt, we should not adopt second-best solutions once first-best solutions are developed. So one of the problems I had to face was a fight about privatization. There were people coming from the States, too, leftist intellectuals who came here and preached the superiority of AESOPs [All Employee Share Ownership Plan], which was a marginal solution in the States, but they wanted us to adopt this as a main solution.

So privatization in Poland was delayed to some extent because of the fight of ideas. I fought for fully fledged privatization without banning labor-managed enterprises if they want to be created. The problem is that in no country with a free-market economy do you have a dominating sector. We had a dominating sector of labor-managed enterprises. But there were some intellectuals in Poland supported by Western intellectuals who wanted to block fully fledged privatization in order to create a workers' paradise, or a labor-managed economy, and I thought it was absurd. Then, as I mentioned in economic successful reform, unavoidably you have some dissatisfaction. And groups of people who were pretty high in the official hierarchy of prestige were losing to relatively new people, to new groups of people like accountants and good engineers, lawyers, bankers, etc.

So you have got subjective winners and subjective losers. But even those who belong to subjective losers under good economic reform are objectively much better off than if Poland were Belarus, or if Poland were Ukraine, because compare Polish miners and Ukrainian miners or Russian miners. Polish miners are dissatisfied. Why? Because they lost in relative terms. But their present situation is incomparably better than the situation of the Russian miners or Ukrainian miners. Why? Because in Poland there were sustained reforms, and in Ukraine and Russia, for some reason, such reforms so far have not been implemented.

INTERVIEWER: In Gdansk, I guess the employment has gone from like 15,000 to 3,000.

LESZEK BALCEROWICZ: Ursus is very instructive, the Ursus case and the Gdansk Shipyard case. They have fallen victim to their political position. They thought they were so important due to the political role of trade unions that they resisted privatization. Comparable enterprises in Poland, which did not take such a political position and could not resist privatization or did not want to resist, are now in much better situation than the Gdansk Shipyard or Ursus. But what happened to the Gdansk shipyard? It was taken over by the Gdynia Shipyard, which has been made an enormous economic success. But an outsider who did not work in the shipyard industry, who came from the financial community, first developed the Gdynia Shipyard, and then the Gdynia Shipyard has taken over Gdansk Shipyard. Gdansk Shipyard fortunately stopped being only a museum and is starting to be developed as a living enterprise, giving jobs to the people.