

The Puzzle of Hyperinflation in Poland in 1989

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Abstract

Aim: The paper analyses the period of dynamically rising inflation in Poland in 1989. The author focused on the assessment of the changing socio-economic situation in the turbulent political environment after the conclusion of the Round Table negotiations in April 1989 and, in particular, on the regulatory and institutional causes of hyperinflation in October 1989.

Methodology: Historical, institutional and evolutionary methods were applied.

Results: It is argued that hyperinflation was intentionally created by both the communist government of Rakowski and the next (contract) government of Mazowiecki in 1989. Hyperinflation constituted the first phase of shock therapy, leading to the irreversible and painful socio-economic transformation according to the guidelines of neoliberal orthodoxy.

Implications and recommendations: Both the communist leaders and the Solidarity leadership were heavily influenced by free market ideology already in 1989. Hence, it was rather difficult to implement adequate corrections of the neoliberal principles in Poland. Similar studies of other post-communist countries are recommended.

Originality/value: The research focused on the origins of hyperinflation in 1989, while most studies dealt with the shock therapy implemented in January 1990.

Keywords: hyperinflation, shock therapy, Washington Consensus, neoliberalism, Poland

1. Introduction

The paper analyses the first phase of Polish transformation from a centrally planned into a market economy viewed in the broader historical and political economy perspective. This was a relatively swift transformation from a real socialist regime into a new neoliberal turbo-capitalist system. However, the changes in the political sphere were far from revolutionary. This passive revolution was bloodless, yet at the same time cemented the neoliberal orthodoxy in the coming decades (Szydło, 2020).

Liberals stress the relatively fast GDP growth of the Polish economy in comparison with other Central and East European countries, which was a great achievement of many reform oriented governments in Poland. However, the costs of this turbo transformation were often unnecessarily high. Economic woes and the briefly induced hyperinflation in 1989 were used to explain the necessity to implement fast and radical economic reforms in line with neoliberalism and the Washington Consensus. The top representatives of the communist party and, paradoxically, Solidarity did not oppose this path.

Out of all the 56 documented world's hyperinflation episodes compiled by (Hanke & Krus, 2013), 28 took place in the former Eastern Bloc countries in the last two decades of the 20th century. Of these 28 cases, only in Poland and Yugoslavia did hyperinflation start in 1989, whilst 15 occurred in other countries of the former Soviet Bloc. Ten of these 15 cases were brief (maximum duration of four months), which indicates their induced character. Hyperinflation follows the definition given by Cagan (1956), which states that "an episode of hyperinflation starts when there is a month in which the price level increases by at least 50%". Another study suggests that "when the monthly inflation rate drops below 50 percent and stays there for at least one year, the episode is said to end" (Hanke & Krus, 2013, p. 370). It needs to be stressed that several post-communist countries managed to avoid hyperinflation, namely the Czech Republic, Hungary, Slovakia, Slovenia and Albania.

The inflation rate in Poland markedly increased from 9.4% in 1980 to 21.2% in 1981 and 100.8% in 1982. The socio-economic situation further deteriorated when martial law was introduced in December 1981. In the second part of the 1980s inflation in Poland was higher than in Bulgaria, Hungary, Romania and the then Czechoslovakia (Table 1).

Table 1. Annual percentages of average consumer prices (year-on-year changes)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Bulgaria	2.7	2.7	2.5	6.4	23.9	333.5	82	72.8	96	62.1	123
Hungary	5.3	8.7	15.8	17	29	34.2	23	22.5	18.9	28.3	23.5
Poland	17.8	25.2	60.2	251.1	585.8	70.3	43	35.3	32.2	27.9	19.9
Romania	0.7	1.1	2.6	0.9	127.9	161.1	210.4	256.1	136.7	32.3	38.8
Czech R.				1.4	9.5	56.7	11.1	20.8	10	9.1	
Slovak R.				1.4	10.8	78.3	10.1	23.1	13.4	9.9	
Russia				2.4	5.7	92.7	1353	896	301.1	190.2	

Source: (IMF, 2018).

The political situation in the late 1980s seemed ripe for structural socio economic shift, as several attempts to improve the real socialist system proved unsatisfactory and the USSR leadership (especially Mikhail Gorbachev) turned liberal¹. According to Brzeziński (1989), the intensity of the crisis in Poland was the most acute. The position of the Communists in Poland was further weakened as they lost referendum to introduce reforms in October 1987, yet despite this the reforms continued, namely the so-called price-income operation (the biggest price increases since 1982) introduced in February 1988. The same year was marked by strikes and the meeting of Polish intellectuals with Mikhail Gorbachev in Warsaw in July.

¹ High-level meetings between Ronald Reagan and Mikhail Gorbachev took place in Geneva on 19-21 November, 1985, Reykjavik in October 1986, and in Moscow from 29 May to 2 June 1988) (Gorbaczow, 2014).

2. The Puzzle of Hyperinflation in Poland in 1989

According to the official explanation, workers' excessive demands of pay rises were responsible for empty shelves (shortages of goods) and persistently high inflation in Poland in the 1980s. Surprisingly, in the late 1980s the strikes were often initiated by either non-unionised workers or the trade union accepted by the Communist party, the All-Polish Federation of Trade Unions (OPZZ). "During the atmosphere of apathy, the strikes that broke out at the turn of April and May 1988 surprised both the authorities and to some extent Solidarity" (Roszkowski, 2017, p. 453). Nonetheless, at the end of August 1988 – in the presence of Bishop Dąbrowski – the first informal meeting between Lech Wałęsa and Czesław Kiszczak, the Minister of Internal Affairs took place in order to reduce the intensification of strikes. Solidarity was still illegal since its resolution in October 1982. The vacuum was filled in November 1984 by OPZZ, the communist friendly trade union, leader Miodowicz was a senior member of the Communist Party (PZPR), of the Political Bureau of Central Committee of the Communist Party ("the Politburo") (Skórzyński, 2019, p. 122). His position in the party was so strong that he was able to invite Lech Wałęsa to the TV debate, and according to Skórzyński (2019, pp. 170-171), ostensibly did not consult this with anybody. The debate took place on November 30, 1988 despite numerous controversies, especially within the Communist Central Committee. Wałęsa won the debate broadcast on TV, which greatly reinforced his position as a sensible and decisive leader. It was the first TV appearance of Wałęsa in seven years. A signal of normalisation was also the consent given by the communist authorities to Wałęsa's trip to Paris on December 10-11, 1988 where he was greeted with the highest honours (Roszkowski, 2017, p. 457). There were several other symptoms of the liberal course of the Polish communists towards the West:

- in 1987 top Solidarity officials together with Wałęsa and the opposition representatives met with US Deputy Secretary of State (January), director of ILO (May) and Vice-President George Bush (September) (Roszkowski, 2017, p. 450),
- Radio Free Europe (*Radio Wolna Europa*) stopped being jammed (as of January 1, 1988),
- The famous financier George Soros set up the Batory Foundation (*Fundacja Batorego*) in Warsaw (May 1988),
- Wałęsa met with the Prime Minister of Great Britain, Margaret Thatcher, in Gdańsk during her official visit in Poland on November 4, 1988 (Dudek, 2024; Eisler, 2018).

However, Solidarity was still not legalised, despite being perceived as a constructive or sensible opposition, in contrast to several smaller and more radical anticommunist organizations. The independent trade union (NSZZ "Solidarność") was again legalised² by the court (*Sąd Wojewódzki*) in Warsaw on April 17th 1989, only after the conclusion of the Round Table negotiations on April 5th 1989 (Eisler, 2018, p. 468).

In January 1989, still before the official start of Round Table talks on 6 February 1989, economic liberalisation by the communists was intensified. They implemented a new law regulating the National Bank of Poland (NBP). This was roughly in line with the functioning of a free market economy, yet NBP still lacked a serious basis to conduct independent monetary policy (Polański, 2005, pp. 100-101). Moreover, in January 1989 the monopoly was lifted to conduct foreign trade, and in February 1989, nine state-owned banks were created out of the NBP (Polański, 2005, pp. 100-101). According to (Kieżun, 2013, p. 115), these newly created entities were refinanced by the NBP and staffed by predominantly communist personnel.

² Solidarity was first officially registered in autumn (October-November) of 1980 (Eisler, 2018, pp. 361-362). With the introduction of martial law on 13 December 1981, the functioning of the trade unions was suspended. In October 1982 the new law passed by *Sejm* aimed at rebuilding trade unions starting from company level with the two stage registration process by the court of law (Marcinkowski, 1987, as cited in Chumiński, 2012, p. 901). However, in the same month of 1982, Solidarity was liquidated (Chumiński, 2012, p. 264). This vacuum was filled by OPZZ which was registered in the court of law in Warsaw on April 12, 1985 (Marcinkowski, 1987, as cited in Chumiński, 2012, p. 901). Both OPZZ and its predecessor CRZZ (Centralna Rada Związków Zawodowych) recognised the central role of the communist party (PZPR) and, in fact, was subordinated to it (Chumiński, 2012, p. 246).

The increase of inflation in the early 1989 was prompted by the decision of the Polish Parliament, as of January 1989, to raise public sector wages to 97% of the level of wages in the production sector (Kuczyński, 1992). This decision added to the socio-economic turmoil, but was not sufficient to create hyperinflation. In February-July 1989 monthly inflation did not exceed 10%, but gained momentum in August 1989, two months after the contract (partly democratic) parliamentary elections in June 1989.

Table 2. CPI in Poland (total, change M/M) (not seasonally adjusted) 1989.01-1991.12

1989.01	1989.02	1989.03	1989.04	1989.05	1989.06	1989.07	1989.08	1989.09	1989.10	1989.11	1989.12
11	7.9	8.1	9.8	7.2	6.1	9.5	39.5	34.4	54.8	22.4	17.7
1990.01	1990.02	1990.03	1990.04	1990.05	1990.06	1990.07	1990.08	1990.09	1990.10	1990.11	1990.12
79.6	23.8	4.3	7.5	4.6	3.4	3.6	1.8	4.6	5.7	4.9	5.9
1991.01	1991.02	1991.03	1991.04	1991.05	1991.06	1991.07	1991.08	1991.09	1991.10	1991.11	1991.12
12.7	6.7	4.5	2.7	2.7	4.9	0.1	0.6	4.3	3.2	3.2	3.1

Source: calculations by the author based on (GUS, n.d.).

The soaring inflation was the consequence of the indexation of wages implemented in late July 1989 and the freeing (marketisation) of food prices in early August 1989 (Bałtowski & Miszewski, 2015, pp. 168-169; Dudek, 2016, p. 75). These two measures were implemented by the communist government shortly before the formation of a contract government, with Mazowiecki from Solidarity as Prime Minister and Balcerowicz as Minister of Finance and Deputy Prime Minister.

On 31 July 1989 the newly elected parliament introduced indexation law, while on 1 August 1989 all food prices were deregulated, with the exception of low fat milk and cheese, milk products for infants and bread (Bałtowski & Miszewski, 2015, p. 168). The chief advisor to Prime Minister Mazowiecki acknowledged that the freeing (deregulation) of food prices was a good decision agreed during Round Table meetings and a big step towards a market economy (Kuczyński, 1992, p. 86). According to the law introduced on 31 July 1989, food price increases were 100% compensated for in August and September. This regulation was first introduced by the special parliamentary commission on indexation. During the parliamentary debate on 31 July 1989, M. Świącicki, the speaker of this commission and a senior member of the Communist Party, declared that “food price increases in August and September in 1989 will be compensated for as quickly as possible, in full and in quotas”. Later Świącicki³ became minister responsible for economic cooperation with foreign countries (Minister of Foreign Trade) in the Mazowiecki government.

The necessary changes in indexation law ‘taming’ inflation were implemented by the new coalition government, which on 16 October 1989 replaced the universal (automatic) indexation covering all wages and salaries irrespective of previous pay rises (Bałtowski & Miszewski, 2015, p. 168) with a compensatory one – not so favourable to workers as the previous one; the law was backdated to 1 October, therefore it took 2.5 months to change the indexation law. This was a crucial decision as the universal indexation was a source of hyperinflation and economic destabilisation (Bałtowski & Miszewski, 2015, p. 172). Indeed, the inflation rate jumped above 50% in October 1989. However, despite numerous and massive price increases of the regulated prices between September and November 1989, monthly inflation in Poland fell from its peak of 54.8% in October to 22.4% in November and 17.7% in December 1989. Bałtowski and Miszewski (2015, p. 171) specified price increases of: alcohol by 125% on 25 September and again by 25% on 19 October, petrol by 50-60% on 28 September and again by almost 50% on November 10 and 19, train tickets by 50% on 1 October together with coach tickets by 40%, prescription drugs by 100% on 23 October, postal and telephone services by 150% on 30 October and again by 130% on 1 November, along with electricity by 150%, gas by 100% and heating by 50%, low fat milk by 700%, low fat cheese by 650%, and of ordinary bread by 400% on November 27.

³ In 1994-1999 he was elected President of Warsaw.

These drastic hikes of regulated prices are rarely discussed in the literature, yet it should be pointed out that all these price increases were implemented by the government in the fourth quarter of 1989, i.e. before the official start of the 'shock therapy' in January 1990. Therefore, T. Kowalik questioned the need for extinguishing the fire of hyperinflation in the last months of 1989 that preceded the implementation of the Balcerowicz shock therapy on 1 January 1990 (Dryszel, 2010): "There was no fire. The government used hyperinflation to terrify at that time, while in the fourth quarter of 1989 inflation was quickly going down." The price increases implemented during the first months of the new (contract) government, must have drained a supposedly hefty mass of empty money from the market. According to Lavigne (1995), the consequence of this was the elimination of the monetary overhang which was anticipated due to a wiping out of household savings. The new method of indexation also contributed to this reduction of the inflation rate.

Already on 15 December 1989, Kowalik with two other Polish economists, Herer and Sadowski submitted a fifteen-page paper entitled *Uwagi do programu dostosowawczego (Remarks on the Adjustment Programme)*, in which they claimed that "the considerable inflationary overhang of money seeking goods and destroying the market" was already eliminated. The paper also criticised the 'drainage' measures planned in the adjustment programme which would lead to very high and abrupt price hikes. These shocking measures included "a sixfold increase of coal prices and electricity, lowering the zloty exchange rate, a thirteen-fold increase of depreciation write-offs, an increase in rent and interest rate" (Kowalik, 2012, p. 59). All in all, annual CPI (December to December) shot up to 640.3% in 1989, while the increase of average consumer prices in the same year was much lower at 251.1%. The same applied to deflator GDP, which (according to GUS) amounted to 298.5% in 1989.

This destruction of excess savings caused by engineered hyperinflation seems to contradict the orthodox supply-side economics which advocates high levels of savings. One should realise, however, that a substantial amount of savings of companies and households, due to dollarisation, were denominated in foreign currency (usually USD). According to Bałtowski and Miszewski (2015, p. 184), the share of zloty in the total cash holdings in the economy stayed below 30% by the end of 1989. In addition, the substantial devaluation of zloty against USD (from about 6 thousand zloty in December to 9.5 thousand per 1 USD in January 1990) favoured holders of US currency.

Undoubtedly, indexation was a more obvious cause of hyperinflation. It is worth stressing that indexation was one of the most controversial problems discussed during the Round Table negotiations in Poland, and it still remains a rather mysterious and controversial issue. Disagreements between economists revolve around two decisions: the first one set the general level of indexation and was made in early April 1989, while the second applied solely to food price indexation introduced at the end of July 1989.

Indexation in the then Czechoslovakia agreed by a tripartite commission and scheduled for the first quarter of 1991 was not so generous as in Poland. The overall indexation of wages in 1991 resulted in 16.4% increase of money (nominal) wage, but the real wage rate declined by 24% (Klacek & Hrnčir, 1994, pp. 15-16).

In Poland, senior politicians, economists and historians could be divided into those who either accuse the illegal (until April 1989) Solidarity, or the officially recognised OPZZ of pressing on with generous indexation. The question remains as to why the communist government and later the new government of Mazowiecki, in power from 24 August 1989, so swiftly and open-handedly yielded to the demands of either of the two trade unions. Accusations of populism were directed mainly towards Solidarity, yet it has to be pointed out that owing to the Round Table agreement, the PZPR and its satellite parties were still in the majority in the lower house of parliament (Sejm) after the partly democratic (contract) elections in June 1989.

The list of senior economists who accused Solidarity of advocating generous indexation included: W. Baka (a senior Communist official since spring 1988 and President of the NBP from 1985 to 1988 and from 1989 to 1991), G. Kołodko (Deputy Prime Minister and Minister of Finance in the post-

communist SLD and PSL government), W. Wilczyński (Poznań University of Economics), and interestingly, L. Balcerowicz. T. Kowalik (a left-wing heterodox economist) was one of the critics of Solidarity, however his criticism was mild and tinted with some doubt.

Kołodko (2009, p. 327) claimed that “a short-term hyperinflation was particularly destructive. It was induced by the simultaneous liberalisation of food prices and the irrational, too generous *ex post* wage indexation forced by ‘Solidarity’.” Balcerowicz (1995, p. 384) maintained that “the winning opposition, because of historical preconditions, was formed around the Solidarity trade union. This had its impact in the Round Table agreement, especially in the drastically inflationary versions of wage indexation and various concessions in favour of stronger groups (i.e. miners, railway workers, farmers).” In another work he stated that the opposition managed to force through the indexation of wages and various other allowances and benefits for huge social groups e.g. coal miners, railway workers and farmers (Balcerowicz, 1997, p. 355). In his later book, Balcerowicz (2016, p. 163) asserted that “the country was moving towards economic catastrophe, wages were increasing at a frightening speed faster than prices, the biggest victory of ‘Solidarity’ during the Round Table, i.e. wage indexation, contributed to accelerating inflation.” Similarly, according to Wilczyński (1996, pp. 23, 55), during the Round Table meetings the pro-democratic opposition successfully opted for a high (0.8) and broad compensation index of price increases (wage indexation), as its political aim was to further weaken and finally overthrow the communist rule in future. It was also hardly surprising that senior representatives of the communist government such as Baka, the President of NBP, also maintained that Solidarity, rather than the communist party or the communist trade union OPZZ opted for hefty indexation. Baka (2004a) also accused Solidarity of demanding – with strong support from OPZZ – a high indexation at the level of 0.8 during the Round Table negotiations. He repeated his accusations and claimed that the parliamentary Solidarity club on 31 July 1989 managed to implement broad indexation, which contradicted the Round Table agreement. Baka (2004b, p. 27) also maintained that the implementation of this act of law would “prompt an influx of empty money, deepen the already high wage disparities, destroy the market and accelerate inflation. (...) No government can fulfil its function with such an act of law on its shoulder. It is perceived that this decision was supposed to be a nail in the coffin of the current rule, but the costs were to be paid by society, all the economy, which would lead to its complete collapse” (Baka, 2004b, p. 27). However, this picture was not precise as in reality, throughout 1989 the communist-friendly OPZZ was the most vocal supporter of the broad and full indexation of wages. Moreover, both indexation and food price deregulation were implemented by the communist government. Curious as it may seem, in another study (Baka, 1999, pp. 166-172) he maintained that Solidarity accepted 85% compensation while OPZZ demanded 100%.

Kowalik (2009b, p. 53) claimed that the decision of full indexation was dictated by Solidarity, at the same time (in a reference) he asked himself a question of what was the aim of the Rakowski (i.e. the last Communist Prime Minister) government in conducting this operation one day before his planned resignation – undoubtedly, it was simply impossible that they did not know potential consequences.⁴

It is worth stressing that OPZZ and its leader (a senior member of the communist party, Miodowicz) issued a number of statements in the mass media (namely the official daily party newspaper – “Trybuna Robotnicza”) expressing support for generous indexation of wages and already in February 1989, i.e. during the Round Table talks, opted for a radical change of the economic system. On 14 March 1989, “Trybuna Robotnicza” already informed on its front page that “there is a race between wages and prices”. On the very same page there was a statement from the OPZZ Executive Committee: “Facing

⁴ Two ministers (I. Sekuła and M. Wilczek) in the Rakowski government were businessmen, and K. Olesiak (Deputy Prime Minister and the Minister of Agriculture) was a consistent proponent of the liberalisation of food prices, while A. Wróblewski was earlier involved in talks with the IMF (Kowalik, 2012, p. 29). Moreover, J. Oleksy, the minister responsible for trade unions, who later (in March 1995) became Prime Minister in the post-communist government, together with Olesiak, opted for deregulation. Wilczek was one of the wealthiest people in communist Poland as the owner of several food processing firms and producer of popular washing powder IXI (Kieżun, 2013, p. 114).

worsening material conditions of working people we demand the implementation of indexation of wages, pensions, disability and social security payments in compliance with the concept presented on February 23, 1989.”

Undoubtedly, one of the goals of this pro-communist trade union was to outbid Solidarity. There was a surprising contradiction between OPZZ and the Communists, who during the Round Table talks in February 1989 voiced concern over generous indexation. As early as 28 February 1989 Wesołowski claimed in *“Trybuna Robotnicza”* that full compensation of price increases will definitely intensify inflation as was the case in Brazil and Argentina where inflation rocketed to 600-900%.

At the end of the Round Table negotiations in early April 1989, top Communist officials Jaruzelski and Kiszczak could not change the view of the OPZZ leader Miodowicz, who demanded the full indexation of food prices (Skórzyński, 2019). Curious as it may seem, both the pro-democratic opposition (Solidarity trade union) and the Communist government were in favour of 80% indexation. Therefore, the final Round Table document assumes 80% indexation. However, on 29 June 1989 OPZZ (*Oświadczenie Sekretariatu KW OPZZ, 1989, p. 2*) issued a statement urging Solidarity to change its position on indexation – OPZZ again demanded 100% indexation. Later, on 25 July 1989, Miodowicz repeated the demands of OPZZ in a letter to parliamentarians. It is puzzling that finally, only a few days later (on 31 July), Parliament implemented the broad and full indexation of wages in connection with food price increases in August and September. This was the first act of law implemented by the new contract Parliament.⁵

On 1 August 1989 the government abolished food stamps and deregulated food prices with the exception of low fat milk and cheese, milk products for infants and standard bread, and one day later the government resignation was accepted by Parliament. The last communist government decided to “jump into a free market” in the limited, yet socially and politically very sensitive sphere (Modzelewski, 2013, p. 328). Modzelewski (2013, p. 383) was undoubtedly right to state that “Rakowski and his colleagues were susceptible to the version of economic liberalism which dominated in the Western world, but they gained courage out of necessity and being convinced that they would be understood during Round Table talks.”

Similarly, Baka’s advisor in the NBP, R. Kowalski (Aleksandrowicz & Fandrejewska-Tomczyk, 2016, p. 28) openly acknowledged that OPZZ presented a very hard-line position – the trade union wanted to be visible and to stress its importance. He also maintained that “indexation, plus the needed freeing of prices on 1 August 1989 constituted the two main impulses to the price increases” (Aleksandrowicz & Fandrejewska-Tomczyk, 2016, p. 28).

Roszkowski (1992, p. 404) stated that Solidarity wanted to defend the standard of living by the introduction of partial indexation, knowing that full indexation could increase inflation. OPZZ (the trade union accepted by Communists) wanted to outbid Solidarity and demanded full indexation despite its possible negative effects on inflation. Solidarity was furious but the government side claimed that it also had problems in dealing with OPZZ and that the authentic difference of views was at play here (Skórzyński, 2019, p. 297). Similarly, A. Wielowieyski, a former Senator and high ranking participant of the Round Table negotiations (the direct subordinate of W. Trzeciakowski representing Solidarity at economic table) states that “OPZZ – the communist trade union – was questioning long term work on indexation (...) even the political bureau [of the Communist Party] was forced to reject the objections of OPZZ, which was protesting against any forms of limiting indexation in a situation when wages were increasing faster than prices in the first half of 1989.” It is worth stressing that even M. Świącicki, a senior Party member at that time, acknowledged that economists from both the government and Solidarity in most cases worked relatively harmoniously. The biggest stir was caused by OPZZ which wanted to beat everybody in populism, especially in the case of indexation of incomes.

⁵ 65% of the seats in the lower house (Sejm) were reserved for the PZPR and its satellite parties. Solidarity secured the 35% of seats available to it.

Curiously, already during the Round Table meetings at least some Solidarity economic experts also pressed for full indexation. One of them was J. Beksiak, who in an interview conducted on 28 February 1989 in "Gazeta Bankowa", stated that "our concept of indexation is supposed to lessen the suffering of people" and that "indexation is not propelling inflation, it is rather following it". Beksiak (2015, p. 124) also added "Who said that wages make inflation? Wages are catching up with the costs of living." P. Aleksandrowicz (Beksiak's interlocutor) replied "sometimes they are growing faster", to which Beksiak replied: "Do you believe in data from GUS? I do not. I am not sure whether this basket has proper composition (...)."

Aleksandrowicz expressed surprise by stating that with full indexation there is no chance for balancing the market. Beksiak's reply is worth quoting in full⁶: "There is no chance at all of balancing the market using methods based on wages and prices. Because we do not have a market and because we do not know how much and from where the money comes from. In this situation the application of conventional methods is ineffective. That is why NBP has to cease automatic financing of all whims of the government. In addition, we do not know these whims when prices are 'humorous'. One good is absurdly expensive, the other good is not available as it is distributed ... one does not have a clue. We are told that by demanding the market we are heading towards hyperinflation. What about 600 bn [złoty] of central investment, is it not propelling hyperinflation? What about the budget of the army, is it not inflation? I do not know what is the actual size of the military budget in the not-market economy, where the price is not a price, nobody knows it. I know that it needs to be markedly decreased" (Beksiak, 2015, p. 125).

In this context, it is worth recalling that monthly CPI in February 1989 (i.e. when Aleksandrowicz conducted the interview with Beksiak) amounted to 7.9%, and in the following five months it did not exceed 10%. Even in August and September 1989 monthly CPI stayed below 40%. Only in October 1989 and January 1990 did it amount to 54.8% and 79.6%, respectively, and therefore corresponded with Cagan's (1956) definition of hyperinflation.

All in all, Solidarity's economic advisor was in favour of broad (universal) and automatic indexation that covered all groups of workers with full compensation, rather than a random arbitrary one (Beksiak & Aleksandrowicz, 1989). The concept of 100%, broad indexation was presented as a tool to safeguard the real value of wages of all, not only the privileged groups. It is rather puzzling given that Beksiak, since at least 1981, perceived the introduction of market based rules as the only way leading to reforms in Poland. It could be argued that the real aim of full indexation was to create hyperinflation. Indeed, Beksiak acknowledged that indexation has to be temporary (Beksiak & Aleksandrowicz, 1989). He was not an ordinary advisor to Solidarity, but a leader of a group of economists⁷ who prepared the first major stabilisation programme between 28 August and 28 September 1989. This task was assigned to him by one of the top officials of Solidarity, namely B. Geremek – the leader of the parliamentary group – the OKP (the Citizens' Parliamentary Caucus). The programme advocated "radical systemic changes (...) Such changes cannot be implemented without fast, even very fast, dampening of inflation, strengthening budget management and relaxation of market processes within the country and in foreign relations" (Beksiak, 2015, p. 245). The report by Beksiak's group proposed "the total withdrawal of the state from the economy; a market economy was to come into being spontaneously. There were to be no price regulations and no building of a new system by the state (constructivism). This merely confirmed the extreme, uncompromising laissez-faire policy disclosed by Beksiak at the Round Table" (Kowalik, 2012, pp. 54-54). The programme was not implemented yet it constituted a basis for the Balcerowicz programme. Kowalik (2012, p. 38) even called it "the radical Sachs-Beksiak concepts". The head of the OKP, Geremek, displayed an uncritical attitude toward these concepts

⁶ Translation by the author.

⁷ The authors of the text of the first stabilisation program include: J. Beksiak, T. Gruszecki, A. Jędraszczyk, J. Winiecki. The authors of the smaller parts of the text and consultants included: J. Dietl, J. Eysymontt, S. Kawalec, J. Kuroń, S. Kurowski, D. Ledworowski, A. Leopold, D. Lipton, A. Paszyński, J. Sachs, J. Szomburg, A. Szpilewicz and others (Beksiak, 2015, p. 245).

(Kowalik, 2012, p. 38). As a matter of fact, both programmes were constructed by liberal or rather neoliberal economists.

A number of people from the Beksiak team, e.g. Sachs and Lipton, were later also advisors to Balcerowicz. S. Kawalec – a protégée of Beksiak at the SGPiS (currently SGH) and a participant of the Balcerowicz seminars at the same university in the 1980s – soon became the chief economic advisor to the Minister of Finance, Balcerowicz (Aleksandrowicz & Fandrejewska-Tomczyk, 2016, pp. 183-184).

Undoubtedly, the implementation of the full indexation of the presently deregulated food prices on 31 July 1989 during already the high inflation in the early summer of 1989⁸ required the green light from the communist government and the consent of the newly elected partly democratic (contract) parliament.

Both Sachs and Beksiak held similar views regarding the economic transformation in Poland. The professor from Harvard met and worked with Beksiak before his first encounter with Balcerowicz. According to Kuczyński (1992), Sachs arrived in Poland on 18 June 1989, shortly after the partly democratic elections on 4 June), and already on 11 July presented the concept of taming inflation with one sweep. Interestingly, at that time there was no hyperinflation in Poland, as in June and July the monthly inflation rate stood at 6.1% and 9.5%, respectively.

The doctrine that came to be known as ‘shock therapy’ was forged through Sachs’s experience in Bolivia (Wilson, 2014). Sachs explained that his advice to the Bolivians was based on the monetarist work of Friedman and Cagan, as well as the essay by Sargent, *The Ends of Four Big Hyperinflations* (Sachs & Snowden, 2005). Friedman claimed that: “Only a crisis – actual or perceived – produces real change” (Peck, 2010, p. 4). For Friedman, hyperinflation was less a crisis to be solved than an opportunity to be utilised, as a state of emergency in which radical free market reforms could be rapidly implemented (Wilson, 2014).

On 28 July 1989 J. Sachs with his assistant D. Lipton put forward “The outline of the economic programme of Solidarity”, which was a jump into the market economy (Kuczyński, 1992). However, Sachs first met with Balcerowicz (the future Minister of Finance and Deputy Prime Minister) surprisingly late on 4 September 1989 – only one day before the latter’s planned trip to Great Britain to deliver lectures at North Staffordshire Polytechnic (Balcerowicz, 2025, pp. 20-21). Only eight days later, on 12 September 1989, the new government won a vote of confidence in Sejm. At the annual IMF session in Washington on 26 September, Balcerowicz presented a comprehensive outline of the programme of systemic reforms in Poland. The team of his advisors included: S. Gomułka, S. Kawalec, W. Misiąg, J. Sachs and D. Lipton (Bałtowski & Miszewski, 2015, p. 171). The majority of experts were in favour of fast transformation. S. Gomułka (2016, pp. 81-87) was an IMF consultant specialising in Poland since the mid-1980s, and in April 1989 started to work with Soros on his plan for Poland. Later S. Gomułka became chief economic advisor to L. Balcerowicz. The IMF and other economic advisors from the West played a decisive role in creating Polish shock therapy. However, the views of Balcerowicz changed since he was an advisor to Solidarity in 1981, and they evolved in the strongly liberal direction and became very similar to those of S. Gomułka in 1985 (Gomułka, 2016, p. 76).

Assuming the data provided by EBRD and cited by Balcerowicz (1995, p. 390) were reliable, it is clear that the sequence of price hikes and deregulations in Poland was not adequate: “in the years 1982-1989 the prices of basic consumer goods increased 30-70 times, while the prices of energy 9-10 times”. With this in mind, it is puzzling why Deputy Prime Minister, K. Olesiak, repeatedly pressed for food price liberalisation (already during the Round Table talks) instead of lifting energy prices. Moreover, during the parliamentary debate on indexation (on 31 July 1989) Olesiak powerfully supported deregulation: “blocking deregulation would lead to hunger” and maintained that the government had been working on this concept since October 1988. Such emotional and alarmist voices resembled

⁸ Less than two weeks before (on 19 July 1989) W. Jaruzelski was elected by the parliament to the position of President of Poland (the Polish People’s Republic).

Malthusian rhetoric evoked by the neoliberals during crises and created a perfect setting to introduce extraordinary measures such as shock therapy.

An additional cause of hyperinflation in late 1989 was the expansionary policy conducted by the NBP, whose President at that time was W. Baka (a member of the Politburo of PZPR from 1988 to 1989). The monthly inflation rate in September, October, November and December of 1989 amounted to 34.4%, 54.8%, 22.4% and 17.7%, respectively, while the annual refinancing loan rate was set at 56%, 72%, 100% and 140%, respectively. The real interest rates were significantly negative what caused an incessant hunger for money and, in consequence, further fuelled inflation (Bałtowski & Miszewski, 2015, p. 171). Baka was appointed the President of NBP by Sejm on 12 September 1989 (the same day as the formation of T. Mazowiecki's government) and held the position until the end of January 1991.

3. Conclusions

It is hard to argue with Beksiak (2015, p. 132) that "the government of Mazowiecki inherited violently increasing inflation from the last communist government" yet his statement that "wages and incomes were catching up with or even overtaken prices" is debatable as the monthly inflation rate declined from 54.8% in October to 22.4% in November, and 17.7% in December 1989.

The relatively brief hyperinflation in the last quarter of 1989 was intentionally created by:

- the generous indexation law implemented by the contract Sejm in the final days of the communist government of M. Rakowski,
- the deregulation of food prices (the last decision of the communist government implemented one day after the introduction of the indexation law),
- the extremely expansionary monetary policy conducted by the NBP under the presidency of W. Baka,
- the massive increases of the administered prices by the government of T. Mazowiecki, with L. Balcerowicz as Deputy Prime Minister and Minister of Finance.

Kołodko (1991, p. 14) confirmed that hyperinflation was "induced". However, this mainly applied to the government of T. Mazowiecki: "the hyperinflation which started in Poland during the summer of 1989 was to a large extent induced, since its technical causes alone – in spite of the price explosion already in August – in September could still have been brought under control or at least radically neutralised. The choice of using inflation to curb inflation was also encouraged by the practical situation, especially the coincidence of a change of government and an outbreak of rampant inflationary processes happening at the same time." In his later paper, Kołodko (1993) repeated that "temporary hyperinflation [in Poland] was of an induced character" and was provoked by:

- political struggle,
- the conviction that it would lower real wages and depreciate the value of money balances especially held by households,
- the conviction that it would be easier to overcome than the shortageflation,
- the almost full liberalization of prices, the deep money devaluation and the rise in credit costs up to their real level."

According to Kołodko (1993), "the achievement of the above objectives was not possible other than by passing through the hyperinflation phase." Hence, this staunch critic of shock therapy criticised only the second phase of the Balcerowicz plan, i.e. the shock therapy, and in his two papers from the early 1990s he stressed that it was necessary. He claimed that socialist economies in the short term faced a trade-off between open (price) inflation and shortages.

In fact, both the communist government of Rakowski and that of Mazowiecki played a decisive role in this shift into the market economy. The outburst of hyperinflation in the fourth quarter of 1989

was engineered by both governments advised by mainly foreign experts (such as G. Soros, J. Sachs, D. Lipton, S. Gomułka) and economists from the IMF.

The hyperinflation was used as a first phase of treatment of the disease of socialist economy, while the initial shock caused by hyperinflation was exploited to rationalise the necessity to implement even more decisive and painful reforms (the shock therapy) according to the guidelines of the Washington Consensus.

Both the top communist politicians and the leaders from Solidarity, with a few exceptions such as Karol Modzelewski⁹, were in favour of a radical transformation into the market economy. The Balcerowicz plan was a work of constructivist, imitative, top-down, and altogether elitist thinking (Morawski, 2020, p. 98). Solidarity decided to spread a protective umbrella over the government during the harsh transformation period. In return, however, this independent trade union (with strong ties with the Church) was unjustly accused of populist demands of high indexation.

The by-product of shock therapy was high unemployment, despite early retirement programmes, and growing inequality. According to Bugaj (2015, p. 87), the passive stance of the Church and Solidarity strengthened the conviction among many people that there was no alternative to the government policy. Additionally, communists did not do much to create effective social safety net to relieve the poverty, but, at the same time, eagerly defended the privileges and pensions received by the members of nomenclature (Aslund, 2010, p. 250). The workers were backed by John Paul II in his eminent encyclical *Laborem exercens* of autumn 1981, yet people simply stopped referring to it after 1989 (Morawski, 2020, p. 99).

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⁹ The Order of White Eagle (the highest honour of the Republic of Poland) was awarded to both Modzelewski in 1998 and Balcerowicz in 2005 by the President of Poland, A. Kwaśniewski.

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Zagadka hiperinflacji w Polsce w 1989 roku

Streszczenie

Cel: Artykuł analizuje epizod dynamicznie wzrastającej inflacji w Polsce w 1989 roku. Skupia się na ocenie zmieniającej się sytuacji społeczno-ekonomicznej w turbulentnym otoczeniu politycznym po zakończeniu obrad Okrągłego Stołu w kwietniu 1989 roku, a w szczególności na regulacyjnych oraz instytucjonalnych przyczynach hiperinflacji w październiku 1989 roku.

Metodyka: Zastosowano podejście historyczne oraz metody ekonomii instytucjonalnej i ewolucyjnej.

Wyniki: W artykule wskazuje się, że hiperinflacja została celowo wywołana zarówno przez rząd komunistyczny M. Rakowskiego, jak i kolejny (kontraktowy) rząd T. Mazowieckiego. Hiperinflacja miała stanowić dowód na konieczność przeprowadzenia szybkiej, bolesnej i niedającej się cofnąć transformacji ekonomicznej i systemowej (terapia szokowa), prowadzonej zgodnie z wytycznymi konsensusu waszyngtońskiego.

Implikacje i rekomendacje: Przywódcy komunistyczni oraz liderzy Solidarności znajdowali się pod silnym wpływem wolnorynkowej ideologii już w 1989 roku. Z tego powodu trudno było wprowadzić niezbędne korekty systemu neoliberalnego w Polsce. Rekomendowane jest przeprowadzenie podobnych badań w innych krajach postkomunistycznych.

Oryginalność/wartość: Badanie koncentruje się na identyfikacji źródeł hiperinflacji w 1989 roku, podczas gdy większość opracowań zajmuje się terapią szokową wprowadzoną w styczniu 1990 roku.

Słowa kluczowe: hiperinflacja, terapia szokowa, konsensus waszyngtoński, neoliberalizm, Polska
