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Rhetoric vs. Reality Revisited

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Abstract

This paper is a draft of a chapter in a forthcoming book by Chris Coyne on trade and globalization. When the book is published, information will be posted on the Mercatus Center Web Page: http://www. Mercatus.org/globalprosperity

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The ideas presented in this research are the author's and do not represent official positions of the Mercatus Center at George Mason University.

"If transition is difficult, and development is difficult, it is not obvious why doing both simultaneously should be easy. The difference between China's success and Russia's failure in reforming agriculture was, if anything, even greater than the two countries' success in reforming industry.

One attribute of the success cases is that they are 'homegrown,' designed by people within each country, sensitive to the needs and concerns of their country. There was no cookie-cutter approach in China or Poland or Hungary. These and all the other successful transitioning countries were pragmatic—they never let ideology and simple textbook models determine policy.

(Joseph Stiglitz, *Globalization and Its Discontents*, p. 186)

I. Introduction

In *Globalization and Its Discontents*, Joseph Stiglitz is one of the most recent economists to make the case for a gradual approach to economic reform. After looking at the successful transitions in China, Hungary, and Poland, Stiglitz (2002: 188) reaches the conclusion that "gradualist policies lead to less pain in the short run, greater social and political stability, and faster growth in the long [run]." While Stiglitz speaks with an air of confidence about the merits of gradualism vis-à-vis shock therapy, there is no conclusive evidence that a gradual approach outperforms more rapid reform approaches.

In the debate over shock therapy versus gradualism, there are literally hundreds of articles defending one side or the other. Throughout this debate, one's priors are undoubtedly the best predictor of the conclusions one reaches. Biases certainly come into play when we look closely at Stiglitz's *Globalization and Its Discontents*. While comprehensive definitions of shock therapy and gradualism are lacking in the literature, Stiglitz confidently asserts that wise gradualism—whatever this term means—

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outperforms a rapid reform approach. Throughout the book, he adamantly defends gradualism as the only real path to reform.

This paper is an attempt to set the record straight on the evidence for and against shock therapy. It is *not* an attempt to address the overall debate on shock therapy versus gradualism. This paper is instead a plea to the economists doing work on transition and development economics to make sure they have their stories straight before making policy pronouncements in favor of a particular reform approach.

While Stiglitz correctly points out that China, Hungary, and Poland have experienced high rates of economic growth, he is often fooled by the rhetoric of leaders. By only paying attention to the pronouncements of the reformers, Stiglitz believes that China, Hungary, and Poland were experiments in gradualism. When we look at the actual reforms in China, Hungary, and Poland, it becomes quite clear that they were, in fact, the kind of "radical reform" experiments that Stiglitz finds appalling.

Stiglitz mistakenly labels the reforms in China, Hungary, and Poland as experiments in gradualism. Yet, he never mentions the many unsuccessful gradualist experiments. If there were ever operational definitions of shock therapy and gradualism, it would be interesting to see how the *average* shock therapy country performed when compared to the *average* gradualist country. Looking at the overall picture would be far more fruitful than looking at a couple of outliers on each side.

Unfortunately, Stiglitz's focus on the exceptions continues when he makes the Czech Republic the representative of everything that is wrong with the "shock therapy" approach to development. As we will see, the Czech Republic was not the laissez faire experiment Stiglitz makes it out to be. Again, Stiglitz seems to be fooled by the rhetoric.

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In addition, the Czech Republic has done far better than Stiglitz suggests. When looking at post-communist growth, Stiglitz (conveniently?) adjusts the time horizon to make the Czech Republic look far worse off today than they were in 1989. However, if we are more realistic and use 1991 as our base year, the Czech Republic has actually performed quite well when compared to its peers.

The paper is organized as follows. The next section discusses the empirical record of shock therapy versus gradualism, and we pay close attention to the cases Stiglitz mentions. In the third section, we ask whether the reforms that in countries like China, Hungary, and Poland were really gradual. Section four asks the opposite question: was the Czech Republic really a failed experiment in radical reform? When we look closely at the evidence, things are not what they seem: the "gradualist" successes discussed in Section Three were, in a fundamental sense, experiments in "shock therapy;" by contrast, the Czech Republic's failed experiment in "shock therapy" was neither a complete failure, nor an experiment in radical reform. Section five attempts to make sense out of this *Alice in Wonderland*-like result. Economists, like Stiglitz, have misunderstood reforms in transition economies because they have confused the rhetoric and the reality of the reform process. I discuss this in more detail in section five. Section six concludes.

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II. Gradualism vs. Shock Therapy in Practice

A. Successful Gradualism

Time and again, defenders of gradualism point to China as an example of a

gradualist country enjoying high rates of economic growth (Stiglitz 2002; Murrell and Wang 1993; Dewatripoint and Roland 1992). From 1980-2002, China's economy has grown at the remarkable rate of 8.2 percent per year.[1] The average individual in China went from an annual income of $708 in 1980 to an income of $4,054 in 2002.[2]

Rapid economic growth in China has translated into significant improvements in overall well-being. Household final consumption expenditures have increased at an average annual rate of 8.5 percent; individuals in China are able to purchase more goods and services than ever before. Chinese citizens are also becoming better educated. Secondary school enrollment increased from 46 percent of the eligible population to 68 percent in 2000; over the same period of time, literacy rates increased from 67 percent to 91 percent of the adult population. Perhaps most important of all, China's development has led to increases in life expectancy and improvements in public health. The life expectancy at birth for a person living in China has increased from 67 in 1980 to 71 in 2002. Over that same period of time, infant mortality rates declined from 49 per 1,000 births in 1980 to 30 per 1,000 births in 2002.

China's successful transition is often thought to be a gradual one because it relied on partial privatization of agriculture. Rather than auction off communally owned land, China went about granting ownership rights to crops and only later gave individuals the right to buy and sell land. By sequencing the reform process, individuals were able to assess the legitimacy of the reforms each step of the way. They could then determine whether there should be further reform in different sectors after assessing the first rounds

[1] All data comes from the *World Development Indicators, 2004*. The average rate of economic growth is based on the change of per capita income from 1980 to 2002.

[2] These figures adjust for purchasing power parity, and they also assume a constant, 1995 U.S. dollar.

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of reform. Rather than impose an all or nothing “big bang,” China was successful because they went slow with their reforms. In so doing, they gave individuals plenty of voice in the reform process and time to adjust to new changes.

Gradualists tell similar stories of the reform process in Hungary and Poland (Kolodko 2004; Stiglitz 2002; Johannes 1999). If we trust the pre-1989 data, Hungary’s average annual growth from 1980-2002 was 1.6 percent per year. Hungary’s post-communist growth from 1989-2002 was 1.3 percent per year. While these rates seem unimpressive at first glance, it is important to keep in mind the low overall levels of development in 2002 when compared 1980 or 1989: when compared to 1989, only a handful of post-communist countries are at higher levels of per capita GDP today. Again, we must first assume that the 1989 data is accurate. If we take the data at face value, then, Hungary’s post-communist growth is remarkable. They enjoyed positive economic growth from 1989 to the present. Throughout Eastern Europe and the former Soviet Union, positive economic growth is the exception, rather than the norm.

Like China, Hungarys’ economic growth has translated into significant improvements in overall well-being. Since 1980, individuals living in Hungary have spent 1.1 percent of their income on final consumer goods. Vehicle ownership increased from 212 per 1,000 people in 1990 to 271 in 1999; television set ownership increased from 310 per 1,000 people in 1980 to 475 per 1,000 people in 2001.

In addition to improvements in material well-being, many social indicators also reflect improved conditions for the average Hungarian. Life expectancy has increased from 70 in 1980 to 72 in 2002. Infant mortality has declined from 24 deaths per 1,000 live births in 1980 to 8 deaths per 1,000 live births in 2002. In addition, secondary school

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enrollment increased from 70 percent of available students in 1980 to 98 percent in 1999. The data tells a similar story of Poland's recent economic development, and we will spare the reader additional summary statistics.

According to former finance minister Gregorz Kolodko (2000), in the early days of the reform process, there was "plenty of shock and no therapy in these reforms." Fortunately, Poland quickly realized that "shock therapy" was "inappropriate for societal change" (Stiglitz 2002: 181). Poland then switched gears and took a more gradual approach. In so doing, they have been the most successful post-communist country. They learned quickly not to base reforms on a "shock therapy" approach, and Poland's leaders went about "explicitly rejecting the doctrines of the Washington consensus" (Stiglitz 2002: 181).

The gradualist defense of Hungary is a similar one. Partial market reforms, dating back to the 1970s, made Hungary's transition a smoother one. In addition, its relatively high debt level (as a fraction of gross domestic product) made it more difficult to break the status quo. With a good foundation in place, Hungary's reforms first focused on macroeconomic stabilization and then turned to microeconomic restructuring. By going slow and sequencing reforms, Hungary learned how to crawl before learning how to walk. And, according to the gradualists, the go-slow approach of Hungary's post-communist leaders was the key factor in Hungary's rapid post-communist development.[3]

B. Unsuccessful Shock Therapy

Russia and the Czech Republic are often cited as the cases where the "shock

[3] For lengthier discussions on Hungary's gradual transition, see Halpern and Wyplosz (1998) and Bokros and Dethier (1998).

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therapy" or rapid reform approach to development failed. Reforms in Russia and the Czech Republic were inspired by the Washington Consensus and successful real-world experiments in places like Chile and Singapore. The Czech Republic and Russia both relied on a voucher privatization scheme when selling off nationalized industries; they attempted to liberalize prices and privatize simultaneously; and they tried to avoid issues of justice by moving as rapidly as possible with the reforms.

In Russia, average annual economic growth declined 2.1 percent per year between 1989 and 2002. Adjusting for purchasing power parity, the average Russian citizen's income has declined from $9,766 in 1989 to $7,324 in 2002. Conventional measures of well-being give us a mixed picture of Russia's post-communist development. Life expectancy has declined from 69 years to 66 years, making Russia the only industrialized nation to have ever experienced a decline in life expectancy. Corruption remains an ongoing problem.

Yet, some indicators point to Russians being better off today than they were in 1989. Between 1990 and 2002, household consumption of final goods and services averaged 1.9 percent. Between 1990 and 2000, vehicle ownership increased rapidly from 365 per 1,000 people to 538 per 1,000 people. Television set ownership also increased rapidly throughout the 1990s. Some even claim Russia is now "a normal country" (Shleifer and Treisman 2003).

The Czech Republic's post-communist growth record has also been criticized by gradualists. Between 1990 and 2002, the Czech Republic's average annual rate of growth was a mere .65 percent per year. When looking at the Czech Republic's growth

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rates between 1990 and 1999, Stiglitz (2002: 186; emphasis in original) correctly concluded that "*relative to where it was in 1989, the* republic has fallen behind."

Unlike Russia, the evidence is less ambiguous for the Czech Repbulic. Czechs are clearly better off today than they were in 1990. Vehicle and television ownership rates are nearly double those of 1990. Infant mortality declined from 10 deaths per 1,000 in 1990 to four deaths per 1,000 in 2002. Life expectancy increased from 72 in 1990 to 75 in 2002. Finally, enrollments in secondary schools are at their highest levels ever.

III. Were the Successes Really Gradual?

Stiglitz and other defenders of gradualism (see, for example, North 1999) make sweeping claims and oversimplifications regarding the nature of a country's reforms. The messy process of categorizing countries as gradual or rapid reformers is, in fact, a quite difficult process. Defining countries as "gradualist" or "rapid reforming" is easier said than done because there is no clear theoretical definition of what constitutes gradual reform; nor is there a definition of what constitutes an experiment in "shock therapy." Without a clear definition, development economists looking at reforming countries tend to rely on anecdotal evidence and classification based on eyeballing the data, rather than relying on any kind of strict test or categorization. For example, when talking about Poland, Hungary, and China, Stiglitz confidently classifies each of these countries as gradualist reformers. Yet, some would say that these countries experimented with rapid reform.

China's transition to the market began in 1978 when a massive privatization program was initiated (Hinton 1990). With massive agricultural shortages occurring, the

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government went about reforming China's collective farming system. In 1981, the government granted households limited responsibility over their agricultural production. By the mid-1980s, 98 percent of all farms had adopted the household responsibility method of production (Lin, Cai, Li 1996). Steps were also being taken to allow producers to keep a larger share of their export earnings. By the late 1980s, privatization in China resulted in a doubling of agricultural production.

Since land reform in China took nearly a decade, most observers immediately conclude that China was an experiment in gradualism. But, here again we are at a point of ambiguity over what qualifies as gradual reform. If all of the land reforms had occurred in one year, would they have been rapid? One year and six months? Three years? Five years? Unfortunately, there is no clear line to help us determine whether a reform was rapid or gradual.

More importantly, time is not the only important variable. The scope of the reforms was just as important as the timing. It is feasible for a rapidly reforming country to claim they were done with all reforms in one year when in fact the overall breadth of the reforms was minimal. By contrast, a "gradual" reformer that takes ten years could actually turn a country's economic system upside down.

While it is true that a long period of time passed during the reform period in China, more reform occurred in China than in many countries that are classified as radical reformers. As Weingast and Quin (1997: 86) put it, the main thrust of China's reforms has been a

> …devolution of authority from the central to local governments, in contrast to the more centralized reform in eastern Europe and the former Soviet Union. Along several critical dimensions, China's central government has explicitly limited its

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> information as a way of credibly committing the center not to repeat the pernicious behavior of the Mao era.

While the actual process of reform might appear to be gradual and piecemeal in China, the act of giving power back to local governments was a radical reform measure that got the ball rolling in China.

Thus, the reform process is never black and white. In the case of China, those who think that the central government's devolution of power was the most important step in the reform process will tend to view China's transition as a radical one. By contrast, those who think reforms could have progressed without the decision to decentralize government control tend to place greater emphasis on the sequencing and gradual nature of the reforms.

It is even more puzzling to find Stiglitz lumping Hungary and Poland together as successful gradualists. Stiglitz's (2002: 181) take on Poland is that Poland's post-communist leaders:

> [p]ursued a gradualist policy of privatization, while simultaneously building up the basic institutions of a market economy, such as banks that actually lend, and a legal system that could enforce contracts and process bankruptcies fairly…The country did not do what the IMF recommended—it did not engage in rapid privatization, and it did not put reducing inflation to lower and lower levels over all other macroeconomic concerns. But it did emphasize some things to which the IMF had paid insufficient attention—such as the importance of democratic support for reforms…

While Stiglitz is correct in pointing out Poland's outstanding post-communist growth record, one would be hard-pressed to find a post-communist country that embarked upon more sweeping change and radical reform in its first five years of transition.

Under the leadership of Leszek Balcerowicz, price liberalization and monetary tightening were first tried in Poland. Poland's shock cut its consumer price inflation from

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555 percent in 1990 to 77 percent in 1991 to 45 percent in 1992. Officials at Poland's Central Bank cut the money supply by more than one-third in the early years of reform. Government spending was brought under control, as Poland's government spending as a percentage of GDP declined from 24 percent in 1991 to 16 percent in 1996. Since only a handful of countries have been able to reduce the size of government in the 20th century (see Gwartney et al. 2003), Poland's 40 percent reduction in the size of government in five years is quite remarkable.

Again, our interpretation of Poland's transition depends entirely on what we mean by rapid reform versus gradual reform. Most economists would probably agree that a 40 percent reduction in the size of government in five years seems like a drastic change in an economic system. Yet, for Stiglitz and many other economists wanting to see gradual reform as always and everywhere better than rapid reform, a 40 percent drop in government spending was still a gradual change.

The case of Hungary is a little more puzzling. Like Poland, Hungary's transition was quite rapid early on. Officials were effective in liberalizing prices and bringing down the rate of inflation. In Hungary, consumer price inflation was reduced from 34 percent in 1991 to 19 percent in 1994. Unlike Poland, Hungary's Central Bank never did go about drastically reducing the money supply. In addition, Hungary never experienced a significant decline in the size of government. Throughout the first decade of reform, Hungary's government spending as a fraction of GDP has remained near 10 percent. Here again, though, Hungary's ability to keep the size of government under control is something noteworthy. Many transition economies have failed to constrain the government after the period around 1990 when all governments in Eastern Europe and

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former Soviet Union shrunk. Hungary's ability to keep government small should be viewed as a more radical result than the data initially suggests.

IV. Was the Czech Republic Really an Experiment in Radical Reform?

While singing the praises of prudent gradual reforms, Stiglitz has made the Czech Republic the whipping boy of rapid reform. Many have criticized Vaclav Klaus's reforms as ideological, but impractical. Klaus's "waves" of voucher privatization were said to have lined the pockets of an elite group of insiders, confused the average citizen, and led to a legitimacy crisis in the Czech Republic.

But, like the cases of successful gradualism discussed above, the idea that the Czech Republic was a failed experiment in rapid reform is debatable on two margins. First, was the Czech Republic's transition really an instance of "shock therapy?" If not, then the critics might be picking on a straw man. Second, *even if* the Czech Republic did attempt to reform rapidly, how badly have they really done? As we saw earlier, many social indicators in the Czech Republic point to things being far better today than they were in 1989. In order to determine whether the Czech Republic has "failed," we need to compare it to other transition economies and pause to consider what we mean by success and failure.[4]

At first glance, the Czech Republic's economic performance since the collapse of communism appears to be disappointing. As we can see in Table 1, the Czech Republic has experienced growth of .65 percent per year from 1990-2002, and it ranks fifth out of 20 post-communist countries. For a country promising rapid growth with the rapid reforms, it is disappointing to see the Czech Republic growing at such a slow rate.

[4] Parts of this section are taken from Beaulier (2004).

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Table 1: Average annual change in real per capita GDP (USD 1995 base year) for the Czechoslovak region and post-communist countries from 1990-2002

Country	Average Annual Growth
Poland	3.57%
Albania	2.36%
Hungary	1.64%
Estonia	1.02%
Czech Republic	**0.65%**
Bulgaria	0.13%
Belarus	0.08%
Armenia	-0.14%
Romaina	-0.25%
Kazakhstan	-0.45%
Lithuania	-1.08%
Uzbekistan	-1.22%
Latvia	-1.44%
Turkmenistan	-1.45%
Russia	-2.24%
Kyrgyzstan	-3.96%
Ukraine	-5.13%
Georgia	-5.75%
Moldova	-5.82%
Tajikistan	-5.83%

However, if we make one slight adjustment to our data and compare Czech growth to post-communist countries from 1991-2002 instead of 1990-2002, the Czech Republic's overall growth rate jumps up significantly. As Table 2 indicates, the Czech Republic's average annual rate of GDP per capita growth increases from .65 percent per year to approximately 1.8 percent per year. While the Czech Republic's relative ranking remains the same, the gap clearly widens between those who have experienced post-communist growth and those who have not. When we look at the Czech Republic's post-communist performance, it clearly ranks in the upper cluster of countries.

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Table 2: Average annual change in real per capita GDP (USD 1995 base year) for the Czechoslovak region and post-communist countries from 1991-2002

Country	Average Annual Growth
Albania	5.68%
Poland	4.62%
Hungary	2.95%
Estonia	1.83%
Czech Republic	**1.80%**
Romania	0.98%
Bulgaria	0.85%
Armenia	0.83%
Kazakhstan	0.55%
Belarus	0.22%
Latvia	-0.62%
Lithuania	-0.64%
Turkmenistan	-0.90%
Uzbekistan	-1.09%
Russia	-1.96%
Kyrgyzstan	-3.48%
Ukraine	-4.81%
Georgia	-4.19%
Moldova	-4.83%
Tajikistan	-5.47%

For some, moving the initial year of comparison from 1990 to 1991 might seem problematic. After all, we want to look at post-communist growth as close to the collapse of communism as possible. There are a few reasons for why we should look at growth since 1991 instead of 1990, however. First, the GDP per capita estimates for Eastern Europe and the former Soviet Union for 1990 are less credible than those for 1991. Liquidation of state-run industries and economic reforms in Eastern Europe had hardly gotten off the ground, and GDP per capita estimates were based on dirty accounting practices and exaggerated output figures. Since many negative value-added firms had been liquidated by 1991, the GDP per capita observed in 1991 is probably much closer to the actual post-communist per capita GDP.

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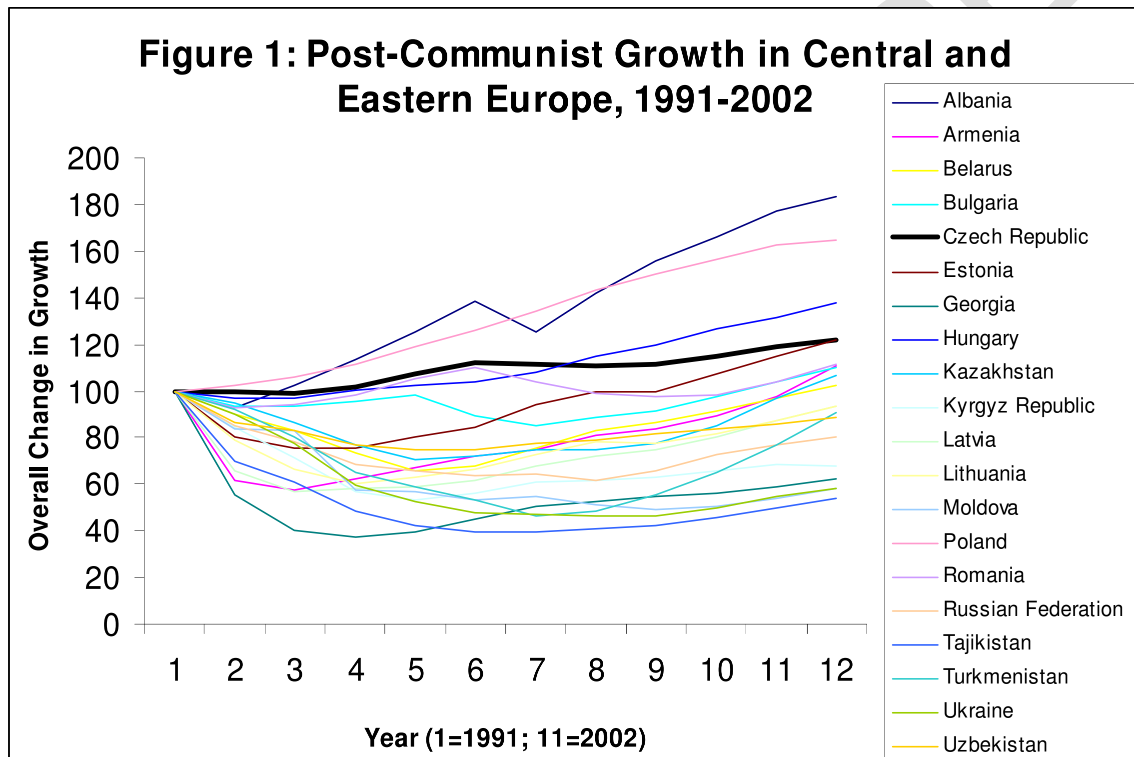
According to Stiglitz and other critics, the Czech Republic's experiment in shock therapy has been a failure because it has failed to outperform many of its post-communist peers. As indicated in Figure 1, however, the Czech Republic ranks fifth out of 20 post-communist countries. It has outperformed Romania, Bulgaria, and Belarus, and its post-communist growth is almost identical to that darling reformer, Estonia.



The fact that the Czech Republic holds up quite well in a cross-section of Central and Eastern European countries is important. As Figure 1 and Tables 1 and 2 suggest, the margin separating Hungary's successful transition from the Czech Republic's "failure" is approximately one percent per year. Of course, one percent over a long period of time translates into a substantial difference in overall well-being. But, the key point is that Stiglitz is drawing the line somewhere between Hungary's growth and the Czech

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Republic's growth. On one side of the line, countries are wonderful successes; on the other, they are abysmal failures. With such a discrete line being drawn, one is forced to wonder if ideology is coming into play in Stiglitz's analysis.

We should also keep in mind the starting point of the Czech Republic. In 1989, 98 percent of the Czechoslovak economy was publicly owned. Freedom of speech and occupational choice were heavily restricted. There were severe shortages of durable goods, and most of the growth in the economy was being driven by military expenditures.

Like most Eastern European countries, the Czech Repulic's GDP per capita experienced a significant decline in the early 1990s. But, the Czech transition has been a lot better than the official figures suggest. First, the *quality* of goods being produced in Czechoslovakia was much worse during communism than the goods produced after communism. Quality improvements are probably misrepresented in the data: as production is shifted out of inefficient military production, for example, and into more efficient production, the initial change might appear to be a negative one for GDP. While a shifting out of state industries into the private sector might not produce an immediate jump in GDP, we would tend to regard an overall reallocation towards the private sector as a desirable change in the long run.

There is an additional reason to think the GDP drop in the early 1990s is misleading. In the late 1980s, government operated companies were undoubtedly overstating their production figures. According to Peter Boettke (2001 [1999]: 227), "it is difficult to 'read' production figures in a world of negative-value added firms." In many cases, "curtailing production…is actually a step toward increasing production and

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exchange efficiency." Shleifer and Treisman (2003) make a similar point when they write,

> In order to obtain bonuses [under communism], managers routinely inflated their production figures. With the end of central planning, the motive for such distortions disappeared; rather, managers now wished to under-report output in order to reduce their tax bill.

Furthermore, when we broaden our analysis to include other indicators, the contraction in overall output in the early 1990s looks less severe. As was said earlier, Czechoslovakia's public spending as a percent of GDP was 98 percent in 1989. In 2000, the Czech Republic's public spending as a percent of GDP had fallen to 20 percent; Slovakia's government spending declined to 21 percent of GDP in 2000. The decline in government spending as a percent of GDP is an extremely important figure because one of the explicit goals of the reformers was to significantly reduce the State's role in the economy. As Vladimir Dlouhy summed up the Czech transition,

> What the critics fail to understand is that our transition was first and foremost an experiment in destatization. Rapid GDP growth would be a nice unintended byproduct of these reforms, but we were most concerned with getting the State out of people's lives.[5]

If, indeed, the primary aim of the reforms was to get the State out of the economy, they certainly succeeded.

V. Why the Confusion? Towards a Standard of Comparison

A number of political economists (Rodrik 1999; Boettke 2001 [1995]) have discussed the rhetoric versus the reality of the reform process. Most discussions of reform in transition economies emphasize the relationship between citizens and rulers.

[5] Personal interview by Peter Boettke, Scott Beaulier, and Susan Anderson with Vladimir Dlouhy at his office in Prague, CZ on July 14, 2003.

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Citizens in transition economies buy the rhetoric of reform. Later on, though, the reality of the reforms turns out to be something much different than the rhetoric suggested. As Peter Boettke (2001 [1995]: 157) puts it, "A major problem confronting the citizen, however, is that he/she does not know whether the regime is sincere or insincere." In an environment where citizens are unwilling to credibly commit to reforms, reformers will spice up the rhetoric of their reforms to get citizens to "buy in" to the reforms. Only later do citizens come to realize that they were fooled by the rhetoric.

In the case of Stiglitz's *Globalization and Its Discontents* in particular, and many discussions about shock therapy in development economics more generally, the economists are the ones being confused by the rhetoric of the reformers. In Stiglitz's case, he took at face value the anti-shock therapy pronouncements of Poland's Gregorz Kolodko. In Stiglitz's mind, there was no real difference between Koldko's gradualist rhetoric and the actual reality of the reforms occurring in Hungary, Poland, and China. Stiglitz bought into the gradualist story without ever looking closely at the policies being pursued in each of these countries.

Similarly, Stiglitz assumed the Czech Republic's Vaclav Klaus and Russia's Yegor Gaidar engaged in shock therapy programs without ever looking at the actual reality of their reforms. In the Czech Republic, for example, Klaus's "shock" was one where general government spending never really declined: in 1991, the Czech Republic's government spending was 23 percent of GDP; in 2002, government spending as a percentage of GDP has fallen only slightly to 21 percent of GDP. Marginal and corporate tax rates have remained at levels in excess of 30 percent throughout the transition period, and Klaus was also responsible for pushing through a controversial value-added tax

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(VAT) that placed a heavy tax burden on tourists and producers in tourist industries. Finally, monetary policy was never as tight as it was in places like Poland or Estonia. In a fundamental sense, then, the "radical reform" of Vaclav Klaus was in reality nothing more than the continuation of the status quo.

Stiglitz's mistaken misclassification of Russia and the Czech Republic are unfortunate and costly mistakes to be making. Policymakers taking advice from development economists deserve to be told the truth about different reform approaches. Those most deserving of the truth, though, are the citizens in developing countries who have been misled by questionable arguments and evidence. Both sides of this debate deserve blame, and the intellectual community must do more to keep personal values out of such an important contemporary issue.

Rather than continue to let our biases enter the debate over shock therapy and gradualism, economists must begin to develop a comprehensive definition of the terms "shock therapy" and gradualism. Clear definitions of shock therapy and gradualism must also include a time dimension. We must also evaluate the speed of the reforms and create a qualitative dimension that addresses the scope of the reforms. The kind of mistakes that Stiglitz has made in *Globalization and Its Discontents*—mistakes where we define shock therapy or gradualism based on what reformers say they are doing—cannot continue to be made.

In addition, we must make sure to focus on the overall picture. Looking only at anecdotal evidence and data that supports one's point is not what development economics is about. While there is no clear categorization of countries promoting shock therapy versus those promoting gradualism, economists should come up with good proxies for

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these two types of reform. Sachs and Warner have developed one useful proxy in looking at openness to trade, but to completely summarize the pace of a country's reform we need to look at more than trade openness.

One useful proxy for the quality of reform might be to look at how rapidly key variables changed in the reform process. Countries that cut their money supply the most; cut year over year government spending the most; increased their dependence on trade the most; and relied on direct auction methods of privatization (Anderson 2004; Beaulier 2004) were, regardless of the rhetoric, pursuing policies more consistent with shock therapy. While developing accurate proxies will prove difficult, good proxies will help to clarify the terms "shock therapy" and "gradualism." No longer will the rhetoric get in the way of our understanding of the reality of reform.

VI. Conclusion

This paper has argued for greater clarity in the debate over shock therapy versus gradualism. In making the case for greater clarity, we have looked closely at Joseph Stiglitz's *Globalization and Its Discontents* to take note of how even the best economists are being sloppy in their understanding of the transition. Throughout his book, Stiglitz oversimplifies the transition, and he reaches incorrect conclusions as to why different countries have succeeded or failed. The paper also attempts to explain why Stiglitz makes these mistakes.

Globalization and Its Discontents is only one example of shoddy work in development economics. Much of the work criticizing or defending shock therapy is filled with biases and logical jumps in arguments. While one could take the cynical view

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that ideology is responsible for much of the disagreement, this paper suggests that the lack of clear definitions of shock therapy and gradualism are also responsible for the confusion.

If the debate over shock therapy versus gradualism is ever to enjoy high rates of return, economists must develop a comprehensive definition of shock therapy and gradualism. Developing proxies that indicate the pace and quality of reforms could help us when attempting to classify different reforms. Until economists reach a clear understanding of the terms shock therapy and gradualism, this debate will continue with most parties involved producing inconclusive explanations and extreme positions based on their priors. Development economics and citizens in developing economies deserve more.

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