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What Failure?
The Czech Republic 13 Years Later

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The bad news, while scarcely offsetting the good, came from the way in which the transition from Communism to freedom and free markets was bungled. Essentially, there were two grave and interconnected errors. First, the reformers didn't move fast enough, worrying about social disruption, and not realizing that the faster the shift toward freedom and private ownership took place, the less would be the disturbances of the transition and the sooner economic and social recovery would take place.

Second, in attempting to be congenial statesmen, as opposed to counter-revolutionaries, the reformers not only failed to punish the Communist rulers with, at the least, the loss of their livelihoods, they left them in place, insuring that the ruling "ex"-Communist elite would be able to resist fundamental change.

In other words, except for the Czech Republic, where feisty free-market economist and Prime Minister Vaclav Klaus was able to drive through rapid change to a genuine free market, and, to some extent, in the Baltic states, the reformers were too nice, too eager for "reconciliation," too slow and cautious. The result was quasi-disastrous: for everyone gave lip-service to the rhetoric of free markets and privatization, while in reality, as in Russia, prices were decontrolled while industry remained in monopoly government hands.

(Murray Rothbard, *Making Economic Sense*, 396-97)

I. Introduction

Following the collapse of communism, countries of Eastern Europe and the former Soviet Union underwent radical economic reform. Mikhail Gorbachev was left without a country when the Soviet Union imploded in 1991. Hungary welcomed competitive elections, and their first elections brought a multi-party democracy and a conservative government committed to an open economy. In one remarkable month, Czechoslovakia went from being a communist country dealing with a minor dissident movement to a non-communist government with playwright Vaclav Havel as president.

Early on, the collapse of communism was celebrated throughout the West. Optimistic observers watched as one former Soviet country after another made a rapid and peaceful transition away from communism. Key Western leaders, such as Ronald Reagan and Margaret Thatcher, were quick to praise (and take credit for) this transition, and the future looked promising for businessmen and citizens of Eastern Europe.

For the first time in 50 years, policymakers were asked to formulate foreign policy for a post-Cold War world—something that was unfathomable even a decade earlier. This brave new world was one in which the threat of a nuclear war was significantly reduced. In addition, individuals throughout Eastern Europe were given tremendous freedoms—freedoms they could only dream of before 1989. They were given the freedom to start up their own businesses, the freedom to choose their own occupation, and the freedom to openly criticize ideas they disagreed with. For individuals in some of the more repressive regimes, this was the first time in their lives that they were free to "vote with their feet" and leave a country if they were dissatisfied with policy.

The era of tremendous optimism did not last long, however. By the mid-1990s, academic and popular criticisms of the reform attempts began to surface. Despite the fact that there were successful transitions in places like Estonia, Hungary, and Poland, the overall verdict on the post-communist transition was an extremely negative one. Economists of every stripe, among them Joseph Stiglitz and Douglass North, were quick to criticize the efforts of the early reformers. According to Stiglitz, "shock therapy" failed because it did not appreciate the role of culture in economic development. As Stiglitz (1999, 3) puts it, the "traditional, narrowly economic approach" to economic development failed because reformers attempted to impose the institutions of private property and the rule of law on populations unfamiliar with these institutions.

Grzegorz Kolodko's *From Shock to Therapy* (2000) offers a similar thesis: the expectations of post-communist reformers were too optimistic, and individuals in post-communist countries would have been better served had reform progressed gradually. Even Douglass North (1999, 2) chided the "shock therapy" approach when he wrote,

> But, essentially, it is an endless story of our having [a] very poor understanding of an enormously complex process in which the uncertainty, again is in all three dimensions. We do not know enough; we are dealing with a world of continuous change; and we do not have any dynamic theory to guide us when we attempt to get from one point to the next.

North implies that there is a certain level of arrogance involved when policymakers and Western advisors attempt to impose their economic and governmental systems on diverse and complex cultures.

In popular media outlets, the rapid reform approach also came under intense scrutiny. In 1996, Belarus' newly elected president, Alyaksandr Lukashenka, delivered a speech in which he told Belarusians that they "do not have to worry [about shock therapy]—we will not yield to pressure and will not implement a shock therapy through which millions of simple working people will suffer" (British Broadcasting Services 1996). In the Czech Republic, media sources like the *International Herald Tribune* tended to emphasize the corruption in Vaclav Klaus's economic transition, and they went so far as to call the Czech transition a "failure" (Peter Green 2002).

Popular outcry over shock therapy's supposed failures led to political turmoil in several post-communist countries. For example, Hungary's conservative prime minister, Viktor Orban, was nearly ousted by opposition socialists in 2002 because Hungary's reforms had widened the gap between rich and poor (Szamado 2002). By the end of the 20th century, many academics, policymakers, and citizens of Eastern Europe saw the first decade of reform as one that brought nothing but higher prices, increased economic fluctuation, income inequality, and massive unemployment.[i]

Despite the criticisms of academic economists and popular media outlets, the reforms were grounded in sound economic analysis: unless reformers moved quickly, problems of simultaneity would bog down the reform process. Moreover, the reforms were widely popular among Eastern Europeans in the early 1990s. But, despite the sound economic logic and widespread popularity of the transition, many Eastern Europeans now look back and regard the transition as a failure.

There are various reasons that Eastern Europeans have become disillusioned with the reform process. Rodrik's (1989) "policy overshooting" argument explains part of the problem: there was a gap between the promises made by reformers and the actual results of the transition. Also, the intellectual and popular consensus that the reforms failed has been another source of discontent for Eastern Europeans. Unfortunately, in listening to the critics of the transition, who have made sweeping claims that write off most of the transition as a failure, people fail to take note of evidence to the contrary. By lumping all of the transition economies together, the critics of shock therapy overlook the successful transitions that have occurred in Estonia, Hungary, and the Czech Republic.

Instead of making claims about the entire post-communist region, it is important that we examine the transition on a case-by-case basis. By looking at the particular experiences of individual nations, a more general understanding of successful and failed transitions can be drawn.

This paper will focus solely on the Czech transition. In the analysis that follows, I combine information from Czech historical sources, popular media outlets, and original data gathered from fieldwork conducted in the summer of 2002 and 2003. My field evidence draws on more than 25 interviews with former officials in the Klaus administration, Czech businessmen, current government officials, and ordinary Czech citizens. The interviews were conducted during July of 2002 and July of 2003. I conducted all of my interviews face to face in Prague, Czech Republic.

This analysis will attempt to set the record straight on the Czech transition to a capitalist economy. The Czech transition should be regarded as a great success and an amazing achievement of "market fundamentalism." As Vladimir Dlouhy, one of the main reformers in the Klaus administration, said:

> The immediate past often looks somewhat unsuccessful. That said, the overall trend [in the Czech transition] has produced unprecedented progress. If someone would have told me in 1989 that by 2003 the Czech Republic would have a capitalist economy, would be entering the European Union, would have a rule of law that at least respects individual liberties, and a stable democracy, I would have told them they were crazy. It seems that when you look at the immediate past, you become a pessimist—hindsight is always 20-20, and there were many things we could have done differently. But, when you look at a longer-term horizon, the progress we have made is breathtaking.

That is not to say that the transition period in the Czech Republic was completely smooth and painless. Problems of corruption, legal ambiguities, and regulatory incompetence, both during the early transition period and currently, continue to be the most commonly talked about political/economic issues in the Czech Republic. But, if we follow Dlouhy's advice and actually take a look at the remarkable economic and social progress that has already been made, we are forced to reconsider the notion that the reforms have failed.

II. The Velvet Revolution

The year 1989 was arguably the most important year of the 20th century. Throughout the Soviet bloc, one country after another made amazingly clean breaks from the Soviet Union. In the summer of 1989, Eastern Europeans saw a noncommunist prime minister installed in Poland. In September, Hungary's government became committed to competitive elections. And, in early November, Eastern Europeans watched as the Berlin Wall collapsed.

Czechoslovakia was also part of this tide. For several years leading up to 1989, the dissident protests against communism had grown both in size and frequency. Several major anniversaries—from the founding of Czechoslovakia in 1918 to the Soviet occupation in 1968—involved large demonstrations in Prague. In January of 1989, the police attempted to counter these demonstrations by jailing one of the main dissident leaders, Vaclav Havel. But, Havel's detention actually produced more protests and far-reaching dissent.

Unlike other Eastern European countries, the communist Czechoslovak regime refused to negotiate with opposition groups. The regime was largely made up of holdovers from the Soviet invasion of 1968, and they were quite reluctant to promise any reforms. Rather than negotiate, the Czechoslovak regime instead suppressed the movement. Thus, the future for Czechoslovakia looked bleak relative to many of the other former Soviet countries. As Vladimir Dlouhy put it,

> We had a meeting with Jeffrey Sachs on a Thursday afternoon. A lot of the talk revolved around the fall of the Berlin Wall earlier that month [November]. Sachs asked us if we expected anything similar to happen in Czechoslovakia. I said, 'We won't have that kind of revolution for many years.' By Monday, the Velvet Revolution had begun.

With a non-compromising Soviet regime in control of Czechoslovakia's government, nobody expected rapid change. But, on November 17th, 1989, a student demonstration commemorating the 50-year anniversary of the Nazi attack on Czech universities turned into a march for "genuine perestroika" (Wheaton and Kavan 1992, 47). The student protest spread, and soon it led to a heated confrontation with Prague police.

What followed after the run-in with the police is the source of widespread speculation. Shortly after the protests, rumors surfaced that a student named Matin Smid was killed in the conflict. Today, most Czech historians maintain that this was a "stage-managed drama manufactured by the security police" (Leff 1996: 79). Some suggest the secret police wanted the opposition to circulate misinformation about the killing and thus discredit them (Leff: 79). Regardless of the source of this rumor, the result was that it intensified the protests against communist rule.

Even though some of the events of the Velvet Revolution remain slightly unclear, the general outcome is quite clear: the communist regime in Czechoslovakia collapsed. While the student demonstration alone was not the sole reason for the collapse, it did serve as a tipping point after which opposition broadened. The Communist Party desperately clung to power in the remaining weeks of November, but, in early December, the Federal Assembly established a government of National Understanding to preside over the transition period (December 1989-June 1990).

During the transition period, Vaclav Havel was appointed president of the independent Czechoslovak state. In June 1990, Havel became Czechoslovakia's first post-communist elected president. In January, 1993, Havel would look on as Czechoslovakia experienced a "Velvet Divorce" in which Czechoslovakia disintegrated into separate Czech and Slovak regions. From 1990-2003, Havel was president of Czechoslovakia and the independent Czech Republic. While Havel presided over the Czech Republic's experiment in "shock therapy," it was Finance Minister (and later, Prime Minister), Vaclav Klaus who was primarily responsible for the reforms.

Among all post-communist countries, Czechoslovakia probably had the most promising growth prospects in 1989. Czech citizens enjoyed a geographic advantage over other post-communist countries in that they bordered well-established capitalist countries. This geographic advantage reduced the costs involved in transporting goods and services to Czechoslovakia.

Relative to other post-communist countries, Czech citizens tended to be more European in their overall outlook. The Soviet Union tried many different measures to maintain a tight grip over Czechoslovakia. Yet, the communism that existed in

Czechoslovakia was less severe than that experienced in the interior of the Soviet bloc in terms of the amount of consumer goods and services available to the population as a whole. As one Czech citizen put it, "Czechs don't like rules. If you make a rule, a Czech will figure out a way to get around it in a week. This is why communism was never as effective here." Thus, when the collapse of communism occurred, the Czechs had more experience with a relatively less restrictive economy in comparison to many other post-communist countries.

In addition, Czechoslovakia's new leaders were perceived as more legitimate than those in many other post-communist countries. Vaclav Klaus was one of the best and most well-read policymakers in all of Eastern Europe, and Vaclav Havel was a hero of the dissident movement that brought down the old regime. With a finance minister taking advice from Nobel laureates at the University of Chicago and a president who was a former dissident leader, issues such as corruption, illegitimacy, and poorly informed policy decisions hardly seemed like potential stumbling blocks for the Czech transition.

III. A Failed Transition?

It is important that we keep in mind the starting point of Czechoslovakia. In 1989, 98% 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.

In contrast, Czech GDP per capita (PPP adjusted) in 2002 was approximately $15,148; Slovakia's GDP per capita (PPP adjusted) in 2002 was approximately $12, 426. The combined GDP per capita for the Czechoslovak region in 2002 (PPP adjusted) was approximately $14,205. Both the Czech Republic and Slovakia have emerged from the transition as upper middle-income countries well positioned in the "New Europe."

In 1990, Czechoslovakia began its transition with an estimated per capita GDP of \$9,730, meaning it was already an upper middle-income country. To put this figure in perspective, Czechoslovakia's 1990 income level put it in the same company as countries like Bahrain (\$11,827), Barbados (10,975), Cyprus (\$10,223), Greece (\$11,156), Ireland (\$12,464), Portugal (\$10,878), and Uruguay (\$9,558).

Like most Eastern European countries, Czechoslovakia's GDP per capita experienced a significant decline in the early 1990s. Economists seem quick to point to these early years as evidence of a failed transition. For example, Stiglitz (2002, 186) criticizes Vaclav Klaus's rapid reforms and points out that "relative to where it was in 1989, the [Czech Republic] has fallen behind." According to Stiglitz, we should look at China, Hungary, and Poland if we want to see successful transitions.

There is plenty of evidence supporting Stiglitz's argument. Estimates from the World Resources Institute suggest that, in 1991, Czechoslovakia's living standards fell to levels not experienced since the late 1970s. If we believe the estimates of Czechoslovak gross domestic product pre-1990, then Czechoslovakia experienced an official output decline of approximately 20 percent between the years 1989 and 1991. By the end of 1991, however, the Czech economy had leveled out, and it grew steadily throughout the 1990s.

There are reasons to think that 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. These 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. Yet, we would tend to regard this overall reallocation as a desirable one in the long run.

There is an additional reason to think that 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 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% in 1989. In 2000, the Czech Republic's public spending as a percent of GDP had fallen to 20%; Slovakia's government spending declined to 21% 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.

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

In addition to this overall "destatization" figure, many other indicators also lend support to the "transition as success" thesis. Life expectancy at birth for individuals living in the Czech Republic and Slovakia (combined) has gone from 71.6 years in 1990 to 74.3 years in 2002. In the Czech Republic, infant mortality rates per 1,000 live births went from 10 per 1,000 in 1989 to four per 1,000 in 2001; in Slovakia, infant mortality rates declined from 14 per 1000 in 1989 to eight per 1000 in 2001.

The improvements in living conditions are also impressive when we look at qualitative improvements in consumption goods. Passenger car ownership per 1000 people, for example, went from 163 to 229 in Slovakia between the years 1990 and 1999; in the Czech Republic, car ownership went from 228 to 335 per 1000 over the same period. Similarly, television sets per 1000 people went from 284 to 407 between 1991 and 2001 in Slovakia; in the Czech Republic, television set ownership per 1000 people went from 340 in 1991 to 534 in 2001.

As these social indicators suggest, living conditions in the Czechoslovak region have improved more than the aggregate figures suggest. Like every other post-communist country, the Czechoslovak region experienced a drop in GDP after the collapse of communism. But, the severity of the contraction wasn't nearly as bad, and the subsequent recovery was even stronger than in many other countries, as shown in the following tables.

The next section puts Czechoslovak regional growth into a comparative perspective.[ii] I first compare Czechoslovak growth to Eastern European and former Soviet Union countries. I then compare Czechoslovak growth to that of all upper middle-income countries. By comparing the performance of the Czechoslovak region to countries with similar initial conditions, we can feel safer in making claims about the Czechoslovak region's relative performance. Finally, I compare Czechoslovak growth *rates* to those of high income, OECD countries. While we would not expect growth *levels* of the Czechoslovak region to catch up to Western Europe and the United States in such a short period of time, the convergence hypothesis suggests that the Czechoslovak rate of growth should be more rapid than many developed countries.

IV. The Czechoslovak Region in a Comparative Perspective

A. The Czechoslovak Region and the Transition Economies

At first glance, the Czechoslovak region's relative economic performance since the collapse of communism appears to be disappointing. As we can see in Table 1, the Czechoslovak region experienced growth of .623% from 1990-2002, and it ranks fifth out of 19 post-communist countries.

If we make one slight adjustment to our data and compare Czechoslovak regional growth to post-communist countries from 1991-2002 instead of 1990-2002, the Czechoslovak regional ranking and growth rate experiences a marked improvement. As Table 2 indicates, the Czechoslovak average annual rate of GDP per capita growth increases from approximately .6% to 1.9%. The Czechoslovak region's relative ranking is now fourth among the 19 post-communist countries. While the Czechoslovak region has not experienced the kind of growth that Albania and Poland have enjoyed, it has experienced growth similar to Hungary and its performance is better than Estonia, Bulgaria, and Romania.

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. But, there are a couple of reasons that we should look at growth since 1991 instead of 1990. 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.

According to the critics, the Czech Republic's experiment in shock therapy has been a failure because the Czech Republic has failed to outperform many of its post-communist peers. As indicated in Figure 1, however, the Czech Republic ranks fourth out of 19 post-communist countries.[iii] As we can see from Figure 1, the Czechoslovak region has outperformed Estonia, Romania, Bulgaria, and Belarus. Throughout the 1990s, Czechoslovak regional growth has been similar to Hungary's. From 1991-2002, Hungary experienced a 34% increase in real GDP. During the same time period, the Czechoslovak region experienced a 23% increase in real GDP. When we look at average annual GDP per capita changes between Hungary and the Czechoslovak region, the margin separating Hungary from the Czechoslovak region is approximately .889% per year.

The fact that the Czechoslovak region compares quite favorably to Hungary is important. According to Joseph Stiglitz, the Czech Republic has been a huge disappointment among the transition economies while Poland and Hungary have been the best performers because of their "gradualist approach."[iv] As Figure 1 and Table 2 suggest, the margin separating Hungary's successful transition from the Czechoslovak's "disappointing" growth is less than .9% per year. Of course, .9% 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 Czechoslovak region's growth. Assuming the line is not drawn right below Hungary's, it is safe to say that the Czech Republic has not failed by much.

B. The Czechoslovak Region and Upper Middle-Income Countries

If we continue to examine Czechoslovak regional growth with 1991 as our starting point, there are some other figures worth looking at. In 1991, the Czechoslovak region's estimated GDP per capita (PPP adjusted) was approximately $8,368.[v] Out of 27 upper middle-income countries, the Czechoslovak region ranked 7th. By 2002, however, the Czechoslovak region ranked 1st among upper middle-income countries with a GDP per capita (PPP adjusted) of approximately $14,205. When compared to the average upper middle-income country's 2002 GDP per capita of $9,488, the Czech Republic and Slovakia clearly hold their own ground.

But, simply comparing Czechoslovak GDP per capita with that of many middle-income countries might not satisfy the critics. After all, we are interested in *post-communist* growth, and comparing overall levels of growth might simply be telling us that the Czech Republic and Slovakia had good initial endowments in 1989. Table 3 addresses this issue. In Table 3, I compare the Czechoslovak post-communist *rate* of growth to all upper middle-income growth rates. As we can see, the Czechoslovak regional ranking is 13th out of 28 middle-income countries.[vi] More importantly, the Czechoslovak regional growth rate is well above the average growth rate for middle-income countries. While the Czechoslovak region has not experienced levels of growth similar to Chile or Poland, its average growth has been close to that of Estonia—an Eastern European country often regarded as a "shining example" of successful reform (Serrill 1997, 7-8).

When comparing the Czechoslovak region to upper middle-income countries, one more useful comparison involves looking at changes in GDP per capita when government spending is omitted from the calculation. As many critics of the East Asian "miracle" have pointed out, high levels of government spending have been driving a large fraction of East Asia's growth. By taking government spending out of gross domestic product, we can get a better idea of which countries are well positioned for future economic growth and which countries have public sectors that are feeding off of the private sector.[vii]

When we take government spending out of GDP, the Czechoslovak regional growth rate increases from 1.9% to 2.3%. In addition, the Czechoslovak's regional ranking moves up one spot to 12th out of 28 countries. The Czechoslovak region is still above the upper middle-income average, and its growth (excluding government spending) actually exceeds Hungary's growth. If we put aside government's contribution to GDP because of its redistributive characteristics, we see that the Czechoslovak region's private performance holds up quite well.[viii]

C. The Czechoslovak Region and Convergence

Table 5 compares the Czechoslovak region's real GDP per capita change to that of OECD countries. According to the convergence hypothesis, countries starting from low initial incomes should be growing faster than countries starting from high initial incomes. Table 5 indicates that, when compared to 24 highly developed countries, the Czechoslovak region ranks 14th. As the table also indicates, Czechoslovak growth has exceeded the OECD average, and Czechoslovak regional growth rates have exceeded many European nations. While the Czechoslovak region has not been a Celtic or Asian tiger, the 1990s did bring the Czechoslovak region growth similar to the United States and New Zealand—two countries with impressive economic growth in the 1990s.

Yet, the glass half-empty interpretation of this table would be that the Czechoslovak region, in contradiction of the convergence hypothesis, has failed to grow more rapidly than many countries that had higher initial incomes. Part of the blame for this slower growth can be placed on the relatively short time-span we are viewing: the

Czechoslovak region has had only twelve years to create the momentum for growth within its economy, and, while shock therapy can jump-start a failing economy, it does not guarantee immediate economic stability and rapid growth. Furthermore, during these twelve years, the world experienced a technological revolution in which many developed countries experienced abnormal levels of economic growth. If we revisited these figures in another ten or twenty years, we would expect the Czechoslovak region to have moved up the rankings even more.

Table 6 looks at Czechoslovak growth when we omit government spending from our GDP figures. While the Czechoslovak regional growth rate only moves from 14th to 12th out of 25 countries, there are a few important points to make regarding the results in this table. First, Czechoslovak regional growth compares quite favorably with Portugal and New Zealand, and Czechoslovak growth exceeds Sweden's growth. The literature attempting to explain Sweden's remarkable growth has exploded in recent years (see, for example, Lindbeck 1997); yet, when we look more closely, Sweden's private sector growth is actually less than the Czechoslovak region's. Also, the Czechoslovak region's growth ranking relative to many European countries lends support to the "new Europe" vs. "old Europe" thesis: the Czechoslovak region's average growth rates rank higher than most of "old Europe."

V. Rhetoric vs. Reality Revisited

As the last section suggests, the Czech Republic and Slovakia should not be called failures. By any reasonable standard of comparison, the Czechoslovak region has been above average in its economic performance. When compared to other Eastern European and former Soviet countries, the Czechoslovak region was in the top third in terms of growth. In addition, when we compare the Czechoslovak region to upper middle-income countries, the Czechoslovak region was in the middle of the pack. When compared to highly developed countries, the Czechoslovak region was also above average, and its growth rate was similar to the United States and New Zealand.

If the Czechoslovak region is above average when we look at these fairly conventional measures, why are people so reluctant to accept the "Czech Republic as a success" thesis? Perhaps part of the reason stems from the fact that bad news sells. The critics were quick to point out the Czech Republic's financial market problems, which resulted in the "pirate of Prague" scandal in 1996.

In many of the interviews I conducted in the Czech Republic, people complained about the lack of legal and regulatory reform; according to many respondents, the Czech Republic is a case of capitalism run amuck. If people have strong priors against capitalism, as the almost universal complaints against the unregulated capitalists imply, then they will tend to place excessive emphasis on the scandals and injustices done during the transition and discount the good things that have resulted from a transition to a relatively open economy. As Pavel Kuta of the National Property Fund pointed out in a personal interview,

> Lots of things have happened in this short period of Czech history. Overall, we have a much more open economy. American history was no different than our early experiment in a market economy. The initial accumulation of capital always goes hand in hand with some illegality.

Perhaps a better explanation of why people are reluctant to see the glass half full when it comes to the Czechoslovak transition stems from the rhetoric used during the reforms under Czech Finance Minister Vaclav Klaus. While Hungary and Poland were radical in their reforms, they escape most criticism because they were not as outspoken and unapologetically capitalistic as Klaus. Klaus was an outspoken advocate of laissez faire capitalism. He had good relationships with Milton Friedman and James Buchanan, and he publicly cited them on numerous occasions. For Klaus, the nature of the reform process was clear-cut. His reformers "accept[ed] Adam Smith's teaching—his vision of a free, democratic, and efficient society in which the citizen, not an enlightened monarch or an elitist intellectual, is king" (Klaus 1997). Klaus—the de facto leader of the Czech transition—was citing Adam Smith (and Friedman, Buchanan, and Hayek) in public presentations. While other Eastern European leaders were undoubtedly inspired by these classical liberal thinkers, Klaus was one of the few who dared to cite the source of inspiration. In so doing, Klaus gave people who were uncomfortable with the logical ends of such free-market rhetoric a reason to hate him.

There is a more understandable—and possibly justifiable—source of discontent among Western academics and the press. Klaus and his reformers promised an awful lot during the reform period. To keep control of the government and maintain public confidence, Klaus downplayed a lot of the costs involved in reform. Klaus knew that the reforms were going to be painful, with tremendous economic uncertainty, high unemployment, and high inflation, but there was no way he was going to sell this picture to the people. Running on a "capitalism is going to hurt for a while" platform would have brought any positive reforms to a screeching halt.

Thus, when individuals confronted the reality of reform, disillusionment quickly set in. To some extent, people had been promised a fairly "free" and immediate transition to a market economy. When Czech citizens discovered that the transition instead might take decades to get them up to Western European standards, the legitimacy of the reforms was immediately called into question. People had little patience for any arguments about how much worse things could have been had the transition not occurred; it was much easier to focus on the things that could have been done better or were not done at all during the early days of the transition.

But, let us imagine a world where the reforms had gone perfectly. Suppose there were no legal or regulatory problems. Suppose all of the cultural considerations had been addressed up front. Suppose Klaus had followed through with all of the reforms he promised. Assuming God could have guided the Czech transition, how much more economic growth would that have produced? The reforms were hardly perfect, and, in ways, they were disappointing. Klaus sold out to political interests, and it ultimately led to his resignation from his role as prime minister in 1996. To quote Dlouhy:

> The man in the [Prague] Castle [Klaus] is a great man. Like all great men, he has made mistakes. History will be the ultimate judge of Klaus's reforms. To this point, if we judge Mr. Klaus's reforms by their outcomes, one would be foolish to call the reform package a failure.

The final reason that so many observers refuse to regard the Czechoslovak transition as a successful one goes back to the issue of growth levels in 1989-1990. Even Joseph Stiglitz takes the 1989 and 1990 GDP per capita levels of Eastern European at face value. Stiglitz never considers the possibility that the 1989 and 1990 figures are seriously inflated. By refusing to adjust the 1989 and 1990 figures, it makes it easy for Stiglitz (2002, 180) to conclude that "by the end of the 1990s, [the Czech Republic's GDP per capita] was lower than the country's 1989 level."

But, in truth, the 1989 figures exaggerate overall growth. In addition, the quantity and quality of final goods and services in the 1989 GDP of the Czechoslovak region was much worse than today's bundle. Even if we take the 1989 data as given, it is unfair to blame the contraction on shock therapy: reforms in the Czechoslovak region did not begin until early in 1991, meaning that the falloff in output from 1989 to 1991, if there was in fact such a falloff, was the result of something besides radical reform. As I have suggested earlier though, there may have been no real contraction in output from 1989 to

1991; instead, the 1991 data may give us a more realistic picture of what life in 1989 was actually like.

VI. Conclusion

This paper has examined post-communist growth in the Czechoslovak region. As we have seen in Section IV, the Czechoslovak region is above average when we compare it to other post-communist countries, upper middle-income countries, or high-income countries. Yet, few transition economies have received more criticism than the Czechoslovak region.

Section V offers some reasons for why observers continue to view the Czechoslovak transition as a failure. As I suggested in Section V, if we use 1989 as our initial year of transition, then the critics have a point in saying the Czechoslovak transition has failed. If, instead, we use 1991 as our initial year, it is hard to regard the Czechoslovak region as anything but an amazing success. My hunch is that the truth lies somewhere in between. The story I am telling here is admittedly a best-case interpretation of Czechoslovak growth. Stiglitz and others have based their interpretations of the Czech transition on a worst-case scenario.

Suppose development economists were presented with the data I have provided in Section IV. If they knew nothing about the different countries in these tables, I doubt that anyone would dare to call the Czech transition a failure. In every table, the Czechoslovak region is above average. Among its post-communist peers, the Czechoslovak region ranks fourth. When we broaden our comparison, the Czechoslovak region still holds up remarkably well.

It is unfortunate that the Czech transition has been called a failure. Other transition economies could have gained valuable insights by looking at the Czech experience when making decisions about their reforms. Instead, Western academics and the popular press call the Czech transition a failure, thereby discrediting shock therapy and other radical reform ideas. Calling the Czech transition a failure has been a disservice to both the Czech Republic and the millions of individuals looking for viable reform options.

Perhaps Klaus's unapologetic pro-market rhetoric explains some of this anti-Czech sentiment. Whatever the reason may be, it is my sincere hope that development economists interested in the economies of transition come to regard the Czech transition as a success in some, if not all, of its stated goals. In this piece, I have shown that the Czechoslovak region holds up quite well against its post-communist peers, upper middle-income countries, and high-income countries. Moreover, when we adopt a "reasonable expectation" approach and ask ourselves what we would have hoped for in the Czech transition by the year 2004, we would be hard-pressed to find areas where the Czechoslovak region has come up short.

The Czech post-communist transition *was not* a failure. The fact that the Czechoslovak region has not been a failure does not thereby imply that it was the most remarkable success story of all transition economies. Some—particularly Czech citizens and defenders of shock therapy—might be disappointed that the Czechoslovak region has not done better. But we must remember how bad things were in Czechoslovakia in 1989. In recalling the first time he was able to leave Czechoslovakia after the collapse of communism, one Czech citizen told me (personal interview):

> I went to Vienna with my mother. I wanted to cry when I looked in the shop windows. There were so many things in the windows that I could only dream of owning before that day. By the end of our trip, my eyes were sore from looking at so many different goods, and my feet were sore because we could not afford public transportation around Vienna.

Today Czech citizens do not have to travel to Vienna to find a diversity of goods and services—they can find nearly everything they need in Prague and other major commercial centers. While they still are not the wealthiest post-communist citizens, the progress made in the Czechoslovak region in the past 13 years has been commendable. and hardly a failure.

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[i] There were some journalists still sympathetic to the rapid reform approach. Hundley (1998), for example, pointed out that "the self-inflicted 'shock therapy' of the early 1990s turned out to be exactly the right remedy" for many former communist countries. In his interpretation of the 1990s, the central European "tigers" were beginning to experience the payoff for incurring the painful reforms of the early 1990s.

[ii] Wherever possible, I look at Czechoslovak regional growth rather than looking only at growth in the Czech or Slovak Republics. The careful critic would correctly point out that by focusing solely on the Czech Republic, I might be picking up the "Velvet Divorce" effect in which the Czech Republic's GDP per capita jumped once it broke ties with Slovakia. By including the Slovak Republic in all of my calculations, I am making the harder case for the Czech Republic's success.

[iii] The data source for Figure 1 comes from the World Development Indicators, 2003. To keep the figure manageable, I deleted Georgia, Krygystan, Moldova, Tajikistan, and Ukraine from the figure. Out of the 19 countries, these were the five worst performing countries.

[iv] It should be noted that there is plenty of disagreement over how gradual in nature the reforms in Hungary and Poland actually were. In Poland, for example, finance minister Leszek Balcerowicz has been praised for his shock therapy approach in which he sought to "privatize, privatize, privatize" Poland's economy. According to the Wall Street Journal (1998), Balcerowicz's reforms were "Central Europe's most radical economic reforms," and by 1991 Balcerowicz was forced to step down because his reforms "had few fans among the country's workers and pensioners." While Stiglitz wants to point to Hungary and Poland as cases of successful gradualism, just how gradual these countries reformed is something that is not unambiguous.

[v] GDP per capita figures (PPP adjusted) for the Czech Republic were not available for 1991. The estimate of $8,368 comes from Dlouhy (2001, 180-181).

[vi] In claiming the Czechoslovak region is 13th among 28 countries, I have omitted the five countries where data was unavailable.

[vii] When examining United States economic growth during the 1940s, economic historian Robert Higgs (1992) examines output levels with government spending excluded.

[viii] The two most interesting results of this adjustment were Lithuania and Botswana. Botswana's recent growth miracle has been heavily driven by government spending, and the sustainability of Botswana's growth has been called into question (Thurow 2002). Lithuania moved from one of the worst performing economies to the best performing economy when government spending was removed. Perhaps one reason why Lithuania moves up so far when we strip government spending from the calculations is the large defense sector inherited from the Soviet Union. While there are significant maintenance costs involved in defense spending, Lithuania does not have to spend a great deal of its GDP on new military equipment. According to the *World Development Indicators, 2003*, the average European and Central Asian country spent approximately 3% of GDP on the military and this accounted for approximately 10% of all government spending. By contrast, Lithuania spent only 1% of GDP on the military (until 2000 when spending jumped to 2%), and military spending as a fraction of total government spending was approximately 6%.

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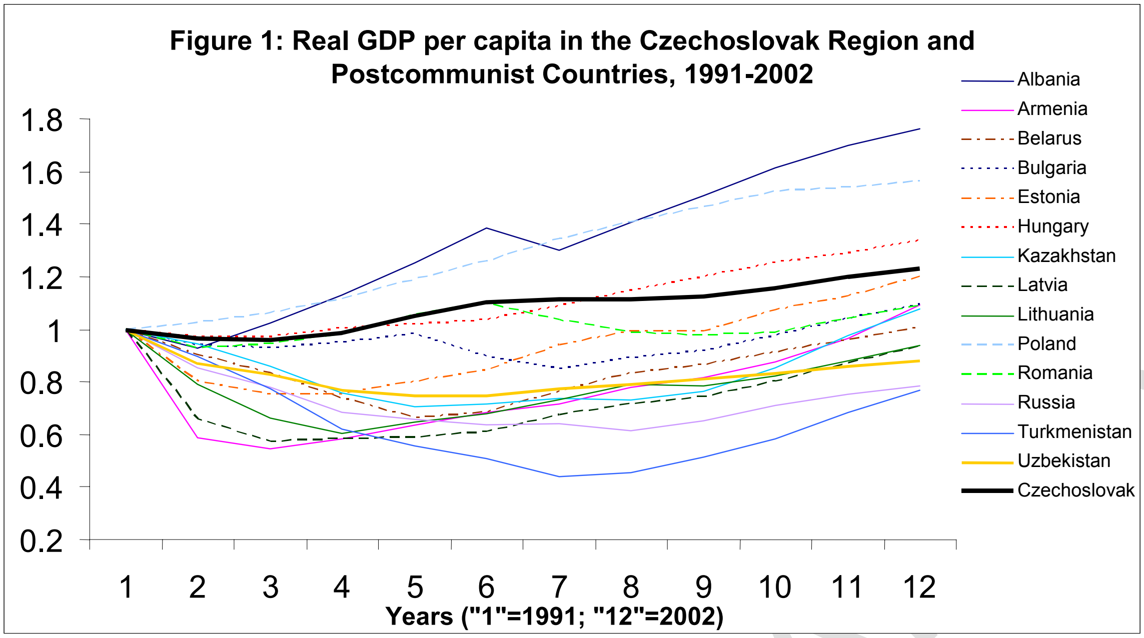

Table 1: Average annual change in real per capita GDP (USD 1995 base year) for the Czechoslovak region and post-communist countries from 1990-2002

Country	Average Annual Growth
Poland	3.421%
Albania	2.092%

Hungary	1.391%
Estonia	0.828%
Czechoslovak Region	**0.623%**
Bulgaria	0.008%
Belarus	-0.002%
Armenia	-0.234%
Kazakhstan	-0.357%
Romania	-0.411%
Lithuania	-0.886%
Uzbekistan	-1.083%
Latvia	-1.253%
Russia	-1.956%
Turkmenistan	-2.342%
Kyrgyzstan	-2.938%
Ukraine	-3.637%
Georgia	-4.339%
Moldova	-4.522%
Tajikistan	-4.737%

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	5.835%
Poland	4.495%
Hungary	2.812%
Czechoslovak Region	**1.923%**
Estonia	1.062%

Kazakhstan	0.650%
Bulgaria	0.341%
Romania	0.320%
Armenia	-0.305%
Belarus	-0.325%
Lithuania	-1.007%
Latvia	-1.089%
Uzbekistan	-1.188%
Russia	-2.073%
Kyrgyzstan	-2.570%
Ukraine	-3.769%
Georgia	-4.004%
Moldova	-4.531%
Tajikistan	-5.041%

Table 3: Average annual change in real per capita GDP (USD 1995 base year) for the Czechoslovak region and all Upper Middle-Income countries from 1991-2002

Country	Average Annual Percent Change in GDP per capita
Chile	4.665%
Poland	4.653%
Mauritius	4.479%
Malaysia	3.753%
Costa Rica	2.824%
Hungary	2.812%
St. Kitts and Nevis	2.768%
Botswana	2.718%

Trinidad and Tobago	2.603%
Croatia	2.466%
Panama	2.187%
Belize	2.147%
Czechoslovak Region	**1.923%**
Lebanon	1.915%
Grenada	1.816%
Estonia	1.647%
Upper Middle-Income Average	1.240%
Mexico	1.158%
Oman	0.961%
Dominica	0.742%
Uruguay	0.307%
St. Lucia	0.286%
Argentina	0.201%
Lithuania	-0.504%
Gabon	-0.515%
Latvia	-0.571%
Seychelles	-0.894%
Venezuela	-1.421%
American Samoa	N/A
Libya	N/A
Mayotte	N/A
Northern Mariana Islands	N/A
Palau	N/A

Table 4: Average annual change in real per capita GDP (USD 1995 base year) for the Czechoslovak region and all Upper Middle-Income countries from 1991-2001 with government spending excluded

Country	Average Annual Percent Change in GDP per capita
Lithuania (1995-2001)	6.189%
Croatia (1995-2001)	5.712%
Poland	5.375%
Chile	5.326%
Mauritius	4.508%
Malaysia	3.852%
Costa Rica	3.527%
St. Kitts and Nevis	2.974%
Trinidad and Tobago	2.790%
Grenada	2.739%

Panama	2.541%
Czechoslovak Region	**2.291%**
Hungary (1991-2000)	2.254%
Belize	2.156%
Lebanon	1.850%
Upper Middle-Income (1993-2001)	1.811%
Botswana	1.782%
Uruguay	1.623%
Mexico	1.500%
Dominica	0.747%
Estonia	0.309%
St. Lucia	0.101%
Argentina (1993-2001)	0.009%
Seychelles	-0.306%
Venezuela	-0.575%
Gabon	-0.774%
Latvia	-2.402%
American Samoa	N/A
Libya	N/A
Mayotte	N/A
Northern Mariana Islands	N/A
Palau	N/A

Table 5: Average annual change in real per capita GDP (USD 1995 base year) for the Czechoslovak region and all OECD countries from 1991-2002

Country	Average Annual Percent Change in GDP per capita
Ireland	8.104%
South Korea	5.469%
Luxembourg	4.043%
Australia	2.872%
Norway	2.603%
Finland	2.524%
United Kingdom	2.461%
New Zealand	2.362%
Greece	2.278%
Canada	2.256%
Portugal	2.182%
Spain	2.100%
United States	2.025%
Czechoslovak Region	**1.923%**

Netherlands	1.889%
Denmark	1.854%
Iceland	1.755%
Belgium	1.697%
Sweden	1.665%
Austria	1.612%
High Income: OECD (Average)	1.584%
France	1.453%
Italy	1.281%
Germany	1.036%
Japan	0.616%
Switzerland	0.370%

Table 6: Average annual change in real per capita GDP (USD 1995 base year) with government spending excluded for the Czechoslovak region and OECD countries

Country	Average Annual Percent Change in GDP per capita
Ireland (1991-2001)	9.470%
South Korea (1991-2002)	5.951%
Finland (1991-2001)	3.323%
Norway (1991-2000)	3.111%
Netherlands (1991-2001)	2.988%
United States (1991-2000)	2.961%
Australia (1991-2000)	2.994%
Canada (1991-2001)	2.984%
United Kingdom (1991-2001)	2.877%
New Zealand (1991-2000)	2.388%
Portugal (1991-2001)	2.352%
Czechoslovak Region (1991-2001)	**2.291%**
Sweden (1991-2001)	2.274%
Iceland (1991-2001)	2.096%
Spain (1991-2001)	2.073%
Greece (1991-2000)	2.016%

Belgium (1991-2001)	1.959%
Denmark (1991-2001)	1.957%
High Income (1991-2001)	1.789%
Austria (1991-2001)	1.761%
Italy (1991-2001)	1.640%
France (1991-2001)	1.514%
Germany (1991-2001)	1.082%
Switzerland (1991-2001)	0.501%
Japan (1991-2001)	0.396%