The Conception of the Czech Economic Transformation in the Context of Central European Economic Thought

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The theme of this contribution is the state of economic thinking in Czechoslovakia in 1989 and how that influenced the policies chosen, and hence the course of, the economic transformation in the following years. This is then put in a comparative context to show how Czech thinking differed from that in Poland and Hungary and how those differences affected policy choices. In this context Czechoslovak means predominantly Czech. The Slovak contribution was relatively small with the important debates that decided economic policy taking place in Prague.

Czech authors have yet to write much on economic thinking in that period. The most comprehensive and serious study is a short book by Zdislav Šulc (1998). There are personal accounts by Tomáš Ježek (1994, 2007), but he writes as much about people as ideas and relives old battles without much new analysis. Background to economic thinking before 1989 and details of Czech economists’ later contributions can be found in English in the author’s works (Myant, 1989; Myant, 1993: Myant, 2003).

2. Long-term similarities

There are similarities between the countries of East-Central Europe. All adopted the Soviet model at one time and all adopted its intellectual baggage, meaning the formal acceptance of the officially-backed ‘political economy of socialism’ within which state ownership and central control over the economy were considered axiomatic. In all of these countries there were periodic attempts at reform which seemed never to overcome the system’s fundamental weaknesses.

There were twists and turns in the levels of popular acceptance of the system but, as a very broad generalisation, there was a long-term trend for increasing disillusionment with central planning and socialism in general on the part of those who had been prepared to give it a degree of support. This followed different courses across the socialist countries and those differences were to be reflected in strategies for transformation after 1989.

3. Poland’s specificities

In Poland the regime could never establish the ideological hegemony seen in Czechoslovakia. There was some support for communist, and still more socialist, ideas after 1945, but there was also strong opposition to domination by the Soviet Union, a strong nationalist tradition and the Catholic church that was associated with that tradition. The failure of orthodox Marxism to achieve absolute dominance was reflected in a significant degree of continuity in intellectual life from the pre-war period. Well-known examples were the prominent economists Oskar Lange and Michał Kalecki who had established international reputations and interests transcending the traditional Marxist framework (cf Kopeček, 2009, esp. pp.146-8).

This degree of liberalism in intellectual life was protected by the regime’s instability: Polish history was punctuated by workers’ protests which forced governments to accept a series of compromises. After 1956 they accepted that agriculture could not be collectivised and agreed, at least formally, to the creation of a form of workers’ self-management. After 1970 they accepted foreign credits to help maintain living standards and economic growth. After the deepest crisis, of 1980 to 1981, they, again at least formally, accepted that radical reform of the economic system was absolutely essential.

4. Hungary’s specificities

In Hungary too there was less of a base for voluntary support for the dominant ideology. After 1956 there was a period of strong repression, but the new regime also sought to win acceptance by taking on board some cautious reform thinking. This was expressed in the New Economic Mechanism, introduced without any accompanying political changes in 1968. It was
5. Czechoslovakia's specificities

Czechoslovakia was characterised by a stronger support base for the Communist Party and for the ideology that it traditionally propagated. There was far less continuity in economic thinking from the pre-war period than in Poland and surviving leading figures from that past were persecuted after 1948. A new generation, schooled initially in Marxist thinking, began to assert itself with more open thinking in the 1960s, but 1968 and subsequent 'normalisation' set Czechoslovak economic thinking on a course that was rather different from those of Poland and Hungary in the 1970s and 1980s. Professional economists were never again trusted by the party leadership.

6. Normalisation

Normalisation after 1968 led to divisions in the life-paths of economists that were sharper than in any neighbouring country. Those who had been active in 1968 were excluded from intellectual life. They either emigrated (and those that did were to contribute relatively little more to policy debates) or could not undertake further scientific work. This delineated a distinct older generation. It should be added that they had had little contact with the ideas of a preceding generation of Czech economists who had been silenced after 1948. They had come via a Marxist background to develop ideas on how the old system needed to be changed.

Nevertheless, the experience of 1968 was a relevant preparation for the conditions after 1989. This finds recognition in a textbook for university students with the claim 'the best economists from the men of 1968 – Karel Kouba, Čestmír Kožušník and Otakar Turek ... rid themselves during their years of forced silence of nostalgia for market socialism and were better prepared for the complications of the transition ... than were the right-wing radicals. However, their circumspection did not find a strong political expression' (Vencovský, Půlpán et al., p. 341). Indeed, they retained an ability and a will to think for themselves while the pressures on the next generation were kept away from innovative ideas.

A younger generation, with less active involvement in 1968, could form the core of the next group of self-management and a state holding company to act as owner of joint-stock companies with powers similar to those of shareholders (Šulc, 2000),
- there was acceptance of the need for a commercial banking system and a capital market so that profits from one firm could be used for investment by another,
- there was acceptance of the objective of an open economy with a convertible currency.

To repeat, these were not the changes implemented. These were the ideas that emerged. In the years after 1989 one of the arguments in polemics over economic policy was that the generation from 1968 wanted to repeat the same measures that had failed in the past. They did not. Some did build from the ideas they had developed in the 1960s but had been unable to see implemented. Even then, their real strength was the ability to look critically and open-mindedly at past policies and thinking.

formulated by specialist economists who had been able to research the weaknesses of the old economic mechanism and who retained the trust of the party leadership.
Czech economists. They learned not to talk about reform (the word was a taboo) and certainly not to talk about 1968. They knew not to attack Marxism in public, but nor was Marx their starting point. They had learned about a range of alternative theoretical approaches and that is reflected in some of their work, albeit largely in the application of particular techniques or concepts that could be used to measure economic performance (production functions, growth accounting, macroeconomic balance, all with applications of statistical and econometric methods). This helped show that there were problems in socialist economies, but it was not much help in proposing solutions. Indeed, it was quite possible to use mathematical and other techniques to construct improved models of a centrally-planned economy and this was a continuing trend in Czechoslovak economic thinking.

Thus this ‘middle’ generation was not well prepared for the situation after 1989, but its members believed that their time had come and used their prestige as expert economists to propose solutions.

By the late 1980s there was another rising generation beginning to appear, but it was not yet important. Among these were individuals with much more explicit commitment to ‘neo-liberal’ thinking: among the ‘middle’ generation Tomáš Ježek was unusual in openly espousing such opinions.

This generational split is more striking than in Hungary and Poland. Even though there were prominent Polish economists who were victimised and many who emigrated, there was still scope for more pluralism of thought than in Czechoslovakia. The instability of the regime and the continuity from past traditions ruled out the creation of so powerful a generation divide.

7. Hungary and Poland in the 1980s

All of the issues referred to above from 1968 were important parts of debates in Hungary and Poland in the late 1980s, and there was considerable public debate among professional economists. Those countries evolved towards more contact with, and openness to, ideas from outside. Hungary joined the IMF and World Bank in 1982 as did Poland in 1987. Both of those countries undertook gradual liberalisation of prices (covering most of consumer spending by the end of the decade), decentralisation of decisions weakening the position of central planning authorities, and the separation of commercial from central banks.

These experiences were not publicly discussed in Czechoslovakia. To repeat, the topic of economic reform was a taboo area. Hungary’s experiences were followed with interest by the very few economists able to travel, but they were not part of public discourse.

8. Thinking in Poland

In Poland the thinking among economists advising the government was increasingly that the old system had failed. It needed very radical changes, but that did not mean support for privatisation and certainly not advocacy of ‘capitalism’. A key step was to be the restoration of market equilibrium, meaning overcoming consumer shortages by increasing prices (eg Kołodko, 1989). This had always met with powerful protests. Even the period of military rule in the early 1980s had brought no solution. Poland suffered from severe disequilibrium on consumer goods markets which followed from the political weakness of the regime: each attempt to achieve balance by raising prices led to popular protests and attempts to repress them only led to less trust in the authorities. Thus, not surprisingly, the position of the Solidarity union was to oppose economic reforms that required sacrifices from the population. With that deadlock very little could be done. Hence the government’s hopes that Round Table discussions would lead to greater public trust in the government and would lead Solidarity to support tough economic policies. Instead, the Round Table led to elections which the government lost.

The 1980s were a period of increasing access to ideas and both official and unofficial publications reflected the shifting mood. The theme of stronger self-management gave way to ideas for administering state enterprises by competing holding companies (Święcicki, 1987) – rather like a development from ideas that Šúlc had produced in 1969 albeit with no contact between the individuals - or for privatisation to investment funds by a voucher method (Lewandowski and Szomburg, 1989).

9. Bigger changes in Hungary

Changes went further in some respects in Hungary with limited opening to sales of firms to foreign companies and with a form of privatisation that allowed cross-ownership between companies and transfer by various means into private ownership. This phase of ‘spontaneous’ privatisation led to strong public opposition and to debate over what privatisation was
meant to achieve (Stark and Bruszt, 1998, pp. 51-79). In Poland too opposition to allowing incumbent managers to use privatisation as a means to personal enrichment was resisted by Solidarity organisations, leading to a degree of employee control over the process (Ost, 2005, pp.153-4).

These changes and discussions in the 1980s were a useful, albeit imperfect, preparation for the next decade. The important point was that there was discussion of some of the key issues, especially transformation of ownership, which could be developed in the context of the first experiences. This phase was missing in Czechoslovakia. As far as the Czech economists who later dominated policy making were concerned, the experience in these two countries was relevant only as evidence that economic reform under socialism was leading nowhere.

In fact, there was remarkably little interest in experience in other countries at all. Šulc (1990) was one of the few exceptions, looking at the post-war transformation in Western Germany. He argued that the German war economy had seen similar distortions to those familiar under central planning, even under private ownership, and that led him to conclude that ownership need not be the key issue. He used this to support his scepticism towards the emphasis being placed on privatisation as a key early step.

10. Small changes in Czechoslovakia

Czechoslovakia’s reforms of the late 1980s followed a period of official complacency. There were no mass protests, as had occurred in Poland, and economic performance seemed more secure than in that country or, for that matter, Hungary. Economic growth had fallen steadily from the mid-1970s, but that was not enough to push the leadership into risking changes to the economic system. The stimulus for modest change was therefore primarily the example of change in the Soviet Union and the first steps amounted to a mimicking of early reforms under Gorbachov. It can be added that there was very little real knowledge of what was going on in the Soviet Union at the time. Had Czechoslovak economists been able to study that country they would have seen a much more chaotic situation than that portrayed in the media.

However, the late 1980s saw a sudden, new-found commitment to ‘restructuring’ (it was still not called reform and still clearly differentiated from anything to do with 1968). It is clear that much of the party leadership was uncomfortable about the new atmosphere in the Soviet Union, but part was willing to accept the need to look for new solutions. The result was a very limited and controlled relaxation.

This was the basis for the creation of the Institute of Forecasting (Prognostický ústav) as a research institute within the Academy of Sciences in 1987. It was headed by Valtěr Komárek, an economist who had been active in 1968, but not as a substantial thinker. He stood somewhat apart from the more radical elements of the time, for example remaining unconvinced of the primacy of market-determined prices. However, he was able to bring to his new institute social scientists from very diverse backgrounds, including important figures from 1968 who could work alongside those from younger generations. The downside, reflecting the continuing suspicion from part of the leadership, was that his institute had no direct impact on policy making and its activities remained unseen by the public.

Instead, a package of new measures, presented as in the Soviet Union as ‘restructuring’, was worked out from the Prime Minister’s office. Measures that had not even been discussed when implemented in Hungary and Poland were suddenly acceptable. Big combines were to be split up, enterprises were to have legally-defined independence, the monobank system was to be ended and macroeconomic equilibrium was to be maintained by tighter fiscal and monetary policies.

11. Criticisms of ‘restructuring’

Open criticisms were not welcomed. Milan Matějka (1988), a professor at Prague’s College of Economics (Vysoká škola ekonomická), was able to publish an article criticising how the policy was formulated – not by economists from outside the government – and the limited nature of the changes proposed, for example with continued government control over prices. A restricted discussion gave some others the opportunity to express support (Vergner, 1988). They all earned a stern rebuke from Jaromír Matějka (1988), the secretary of the committee preparing the changes, who warned that free movement of prices would mean ‘a strongly inflationary road’. The thinking was clear, market-oriented reform risked causing the instability experienced in Poland and, to a lesser extent, Hungary.

There were remarkably few attempts to set out the basis for an alternative. The most outspoken were figures from 1968, with a few allies from the ‘middle’ generation. The former had already suffered victimi-
sation and had no reason to exercise internal censorship and could express the clear view that the changes being proposed were inadequate as they would not create a functioning price system (Kouba, 1989, Ježek and Turek, 1988). Such views only very occasionally crept into the official media.

12. Václav Klaus

The ‘middle’ generation was generally more cautious. A partial exception, and important figure in his own right, was Václav Klaus.

His intellectual trajectory took him to a strong allegiance to neo-classical economics and to Milton Friedman’s views on the centrality of controlling the money supply. It might seem logical for a clearly right-wing economist to reject in total the socialist system, but Klaus was developing a somewhat different view (discussed in Vencovský, Půlpán et al., 2005 and put by Klaus, 1989). His allegiance to what he called ‘mainstream’ or ‘standard’ economic theory meant that he wanted to apply it to the socialist economy. He wanted to argue that it was of such intellectual force as to be applicable in all kinds of societies and he wanted to defend it against what he saw as enemies who were out to cast doubt in that universal applicability.

This is an interesting line of argument. In an atmosphere encouraging free debate it could expect to provoke responses. Ultimately, it is unconvincing. It maybe needs to be set in relation to Klaus’s personal predilection for battling against perceived enemies. He was also to fight other intellectual battles that seemed to many others to make little sense, more recently over global warming.

Klaus’s determination to defend the universal validity of ‘standard’ economic theory led to potentially important policy implications. Thus he argued, in relation to the Czechoslovak economy,
- there is a price mechanism, albeit a very deformed one,
- money does matter and the policies of the central bank can influence enterprises,
- inefficiency is caused by disequilibrium which can be influenced by government policies.

This last point kept recurring in his writings (eg Klaus, 1984). It was not accepted by all economists, but few entered an open polemic over it. Turek (1989b) was an exception, again demonstrating the greater willingness of those from the ‘older’ generation to become involved in discussion and debate. The important implication of Klaus’s position is that the system might still have life left in it as long as government policies were corrected so as to maintain macroeconomic equilibrium. It is a striking position, not least because some of Klaus’s work confirmed that macroeconomic disequilibrium was not a major problem for the Czechoslovak economy – in obvious contrast to Poland – so that there might not be very much to correct.

In fact, Klaus left open the questions of how the system actually functioned and of whether its performance could be improved. He admitted that he did not know ‘precisely where we are, where we want to go and, especially, how to get there’ (Klaus, 1989, p.31). On whether policy changes could be made without systemic changes he was ‘not sure about it’ (Klaus, 1989, p.11). This contrasts strikingly with the confidence he was to portray in later years on a much wider range of issues as an active politician.

His thinking in 1989 led him to a surprisingly favourable view of the changes of the late 1980s, defending his country’s government on a trip to Chicago in August 1989, claiming that ‘we are already in a transitional process concerning the economy’ (Betz-Eck, 1989).

13. A new policy environment

Such thinking was interrupted by the political changes of December 1989. Czechoslovakia could then follow the road already taken by Poland and Hungary.

Poland was the most important example for liberalisation and stabilisation policy. However, it was also a country with very specific conditions, owing to extreme internal disequilibrium and a high level of foreign debt. The first Solidarity government felt politically insecure and felt the need for international help which in turn required IMF approval for its policies. This led it to the ‘Washington Consensus’ strategy that had been applied by the IMF in Latin American countries similarly facing external debt crises.

The government willingly believed advice from Jeffrey Sachs of Harvard University and the IMF accepting a policy for ‘a jump into the darkness’. There was no serious opposition in parliament. In January 1990 most remaining prices were freed, the currency was devalued as imports were freed and severely restrictive policies were imposed.
Precise policies were worked out by a small team around Finance Minister Leszek Balcerowicz who brought together a group made up mostly from old friends in his own age group and working with IMF advisers (Balcerowicz, 1995, pp. 296-304). Thus in this early period – described by Balcerowicz as a period of ‘extraordinary politics’ – inputs from the wider community of Polish economists were not heard.

The result of ‘shock therapy’ was an acceleration of inflation and a rapid drop in output, well beyond what the government had predicted. The breadth of economic thinking over previous years and the strength of employee representation then reasserted itself, at least to some extent. ‘Shock therapy’ came in for strong criticism for ‘over-shooting’, but there was no reversal of liberalisation. The following years saw some relaxation of the restrictive policies and inflation continued at above 10% until the end of the decade.

Hungary did not follow ‘shock therapy’, but essentially the same steps were taken in a slightly more gradual way that avoided a peak in inflation.

Policy makers in Czechoslovakia could have learned from these experiences. In fact, they were hardly discussed in public during 1990 by those who dominated policy making. Following a similar course to Poland could obviously be expected to lead to a similar drop in output and living standards, but that was not acknowledged by policy makers through 1990.

14. Czechoslovakia – following Poland’s strategy

Formulation of the transformation strategy was, from the start, more pluralistic than in Poland. There were different centres. Thus the diversity in economic thinking, hidden through normalisation, was felt at the start. Success for a strategy then depended on political influence and, with little chance of wide understanding of the issues involved, that depended on influence within the new power structure and on how ideas could be presented to a poorly informed political community and wider public.

Komárek, as Deputy Prime Minister with overall responsibility for the economy, was at first in charge of transformation policy at the federal level, but actually did very little and was isolated in his caution over key measures, especially price liberalisation. His inaction meant that the initiative in the federal government moved towards Klaus who had taken the post of Minister of Finance.

Early inaction from the federal level led the Czech government to establish a commission which brought together mostly economists from 1968. Inevitably, they were not widely known beyond this. They developed the ‘post-1968’ model of price liberalisation, scope for new private businesses to develop, commercialisation of enterprises under a state property fund which could play the role of an external owner and gradual liberalisation of imports.

Klaus worked with a group in the federal Ministry of Finance that favoured putting the first emphasis on monetary and fiscal restraint to restore – or rather to maintain – equilibrium. Thus his old emphasis on that theme endured into his transformation strategy. Further key measures were to be rapid freeing of prices and imports and the fastest possible privatisation, which meant using the voucher method. All but the last part of this were close to IMF advice, although Czechoslovakia did not need international help and did not need the same restrictive macroeconomic policies owing to the absence of severe macroeconomic disequilibrium and a low level of international debt. However, there was pride in taking particularly radical steps that earned international attention, as Poland had with its ‘shock therapy’.

There was public debate between these policy positions, but Klaus’s conception for a form of ‘shock therapy’ was victorious. Different means of privatisation were accepted as possibilities, but implementation made possible an emphasis on vouchers, without control from the public or employees over individual projects.

15. Why did one side win?

Klaus’s strategy was appealing as the firmest possible rejection of the past. He spoke with confidence and conviction, dropping the doubts he had confessed to a few months before. In an atmosphere in which few could judge the economic merits of arguments, the perceived political merits of their proponents became decisive. A new group, claiming to be charting a new course (and that was how the ‘middle’ generation that had survived through normalisation by caution, avoidance of excessive originality and self-censorship appeared) had an appeal over an older group that could be portrayed as wanting to revive old ideas. A political struggle against the heritage of 1968 therefore played a big role here. That marked the debate out from those in Poland and Hungary where the division between generations was less clearly linked to divisions over thinking on economic policies.
It is noteworthy how this was conducted. The key was to portray opponents of a particular strategy in blanket terms as proponents of a return to the past. Thus those who had once been involved in trying to reform socialism were portrayed as if their thinking had moved no further. Such was the common currency of political debate. Such also was the combative style of Klaus. Other economists from the ‘middle’ generation proved less lasting as politicians, but could command credibility thanks to some knowledge of ‘standard’ economic theory and a lack of involvement in any previous policy making.

Czechoslovak experience can be contrasted with developments in Poland and Hungary.

Privatisation in Poland was a matter of controversy and delay. There was still a strong bias towards favouring rapid privatisation, but more recognition from those around the government that it was a very dangerous course. Janusz Lewandowski, a ‘pragmatic liberal’ who proposed a version of voucher privatisation in 1989, was Minister of Privatisation for a time in 1991 and tortured himself over the need to find a sensible solution (Lewandowski, 1991). He rejected the Czech form of voucher privatisation as either irrelevant or positively harmful.

Another barrier was the strength of the Solidarity union and of worker self-management which gave employees the power to block privatisation of their enterprises. It was a power they often used. The main form of early privatisation therefore involved effectively handing enterprises to their employees. Some of these firms were rather successful for a time but ultimately, as with other forms of privatisation into domestic ownership, they could not develop without outside capital and technology and increasingly accepted foreign owners. A form of ‘mass’ privatisation was set in motion in 1995, but it was far less substantial than the Czech voucher scheme.

Voucher privatisation was rejected in Hungary in favour of direct sales to foreign companies. A voucher scheme was prepared in 1994, but never implemented. Direct sales to foreigners were not ruled out in Poland and Czechoslovakia, but they were regarded with more suspicion.

16. Why were there these differences?

There were differences in economic conditions, but they do not explain the different policy choices. Important factors seem to be:

- the greater willingness to accept foreign ownership in Hungary,
- the higher level of economic thinking in Hungary and Poland (without exaggerating it) which led to more debate and caution over economic policies,
- the greater public control over policies in Hungary and Poland (again, not to exaggerate) following publicity over the dangers of spontaneous privatisation and due to greater recognition of the voice of employees.

17. Did the differences matter?

The important divergences were over privatisation policies. Voucher privatisation was viewed with scepticism for many reasons. It did not create active owners. It led to a dispersed ownership structure. It brought no new resources to enterprises. It created scope for corruption and for stealing assets. It would hinder rather than help development of a capital market. All of this was foreseen and warned against and broadly confirmed by experience.

The Czech method was at first viewed with scepticism by World Bank officials (for a self-critical review of World Bank thinking, see Nellis, 2002). They became convinced when it was clear that property could be transferred quickly and without political problems – in other words long before they could see and analyse its economic consequences. They kept close to those around Klaus and believed claims that opponents of the scheme really wanted to continue with the old system. The Czech method was presented as the way forward for other countries – in contrast to the perceived dithering in Poland and to Hungary’s policies which were considered a disappointment - and Czech ‘specialists’ were used to propagate versions of the scheme in other countries. By the end of the decade the World Bank view had changed. There was enough evidence that voucher privatisation brought no economic benefits. The organisation self-critically recognised that privatisation without creation of an institutional infrastructure had been counter-productive.

However, end results are not that different. Hungary, the Czech Republic and Slovakia all became heavily dependent on inward investment from multinational companies. Poland, a bigger country with a larger internal market, was less externally oriented. These changes depended more on geography - proximity to Western Europe - and past economic levels than on thinking on economic policies at the end of the socialist era.
A final conclusion on economic thinking from 1989 is that the Czech emphasis on voucher privatisation contributed to the banking crisis of the late 1990s which in turn led to cautious banking policies in the following years. The Czech Republic was therefore less exposed than many other countries to the effects of the world financial crisis of 2008. A policy seemed right in one period, then wrong in another, but may ultimately have had beneficial consequences in protecting against mistakes made in countries that became dependent on financial inflows.

Bibliography
