Economics of Alliances and (Dis)Integration:
An Alternative Interpretation of Transition Illustrated on Czech Economic History

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Abstract

In this paper we aim to show that, in the framework of political economy, pure trade theory and the economics of location, a change in an external alliance (alignment) of a small country with its strategic partner constitutes a causal link to its economic and social dynamics. International partnership, co-operation and trade of a small country are interpreted as a key factor determining the country's social functioning and economic performance. The paper postulates a hypothesis that current transition in the post-Communist Europe is not such a unique phenomenon in human history as is often presumed.

It is demonstrated on the case of Czechia that there were in this century several occasions when the social and economic shake-up was not dissimilar to the recent economic developments associated with "transition". While it is well known that accumulated gains from a gradually proceeding economic alignment (i.e. integration) can be significant, this paper tries to look at a retrograde link: at the national losses from a disintegration of such an alignment. Czech economic history can be used as an illustration how the development of a nation can be influenced by both contingencies, which do not act in a symmetric way.

The theoretical part of the paper (as described above) will be followed by discussing the historical events in the embeddedness of the Czech economy in the European and the world economic affairs in the period 1848-2000. During that period Czech economy experienced several unparalleled changes bringing her from a backward starting point to a booming growth culminating in 1912. Then there were several deep slumps and sharp recoveries, until reaching a secular stagnation in 1980s. The relative ranking of the Czech GDP per capita in the world economy was falling from the 11th position in 1939 to the 13th position in 1950 and finally converging to approximately 40th position during 1961-2000. This is an unprecedented negative record in economic history, which can be explained neither by traditional models of growth nor by the more modern hypotheses of steady state and catching-up. The explanation based on institutional failures which provide incentives for allocating economic activities to rent-seeking, asset stripping and moral hazard, instead for promoting wealth creation and the reliability of markets, seems to be more consistent with past long-term developments in many transition economies.

A/ Method and Concepts of Our Analysis

For many authors transition is understood as an institutional change due to fundamental changes in relative prices and/or changes in socio-political preferences, as was outlined by North (1990). A radical change of this kind entails a **transition to a new equilibrium in such characteristics like ownership, exchange, organisations, dominant economic agents and incentives**. In this paper the transition will be associated with a long-run path of parallel changes in the economic system caused by interdependent dislocations in:

- nature of domestic markets (including their relative prices, competition and institutional set-up),
- structure and intensity of its international trade,
- existing allocation of resources,
- stability of existing structure of ownership,
- political and economic alignments.

There is a close **link between transition and integration**, especially if the studied countries are small. Although some forms of integration could be recognized from the early stages of human organization, this theoretical concept evolved very slowly in the economic literature. It was generally associated with the theory of trade and the internationalisation of markets. In the Ricardian and the neo-classical (Heckscher-Ohlin) theories of trade it was the principle of comparative advantages that integrated the country into the world, provided that the barriers to the exchanges of commodities and factors were not absolute. The "new trade" theories offered a wider horizon for the integration by stressing more the economies to scale, market power, oligopolistic practices and hierarchies for gains on the markets. The theories of customs union introduced into the previous analyses the involvement of the governments and their preferences for institutionalised trade relationships. It was only the practical experiences of the European integration in the last 25 years, which have shown that microeconomic integration should be complemented with both the macroeconomic integration (e.g. in currencies and monetary and fiscal policies) and the institutional integration. It is argued in this paper that apart from the formalized integration at the level of official institutions there is a non-formal embeddedness of behavioural patterns and the moral values of the society that are a part of the processes of economic integration and disintegration. The externalities of the non-formal parameters of integration onto the performance of the economy are also a part of the whole "story". Transition in our sense is a diversion from an original socio-economic integration (alignment) to an alternative one.

The basic argument of this paper was inspired by the **pure theory of trade**: instead of remaining a self-contained closed entity, a small nation can achieve economic gains if it opens up and builds its development on foreign exchanges based on comparative advantages and endowments. In the process of specialisation a small nation can gain per capita more than a large nation. However, higher gains are challenged by higher risks of losses, if the pattern of co-operation is not optimal. In the pure theory of trade a small nation is considered a price taker while a large nation "makes" all prices. The necessity to distinguish between small and large countries is not limited only to economics (see Bauwens, Clesse and Knudsen (1996)). Thus in the context of this paper, which extends beyond the economic exchanges, **large nations (superpowers) dominate the parameters of coexistence with small nations**. Since a superpower is more self-sufficient and self-contained than a small nation, it develops to a large extent autonomously. Therefore the internal mechanism and norms of conduct of one superpower differ from those of other superpowers. This is the reason why **a change in an alignment of a small nation and its deflection to another superpower is reflected in the small nation as a discontinuity**. It rebounds on the small nation which should carry the larger part of the burdens of accommodating adjustments.

Small nations can seldom generate internally all conditions for their modern economic, social, cultural and political development. Without the deployment of ideas and resources of the whole world the economic wealth and growth of those countries would be much lower. Though a change in the strategic geopolitical orientation of a small nation may commence with a seemingly innocent platonic curiosity "to look for an inspiration elsewhere", it may finally lead to a fall under the attraction of an alternative superpower. As a consequence, the country gets caught into **real adjustments** proceeding through all structures of its society: **changes in the organisation of production processes, markets, trade, ownership, competition, division between public and private sectors, fiscal system, politics, jurisdiction and, finally, social values and culture**. The process of real adjustment due to international re-alignment can be described as a process of **international convergence** to the parameters of a new leading socio-economic entity (superpower). The jump of a small country from an existing alignment to the orbit of a new strategic alliance can be also interpreted as a **transition**.

The methodology of the first part of this study is therefore span off the pure theory of international trade and its not always interconnected parts: Ricardian comparative costs, Heckscher-Ohlin theorems, increasing returns to scale, oligopolistic market power games, economics of integration, economies of human capital and networks. However, its off-shoots into other social disciplines (such as the political economy, public choice, institutional economics, political science, game theories, public administration, etc.) become clearly visible, if these are applied in a concrete historical context of a certain nation. It is evident that during the last 200 years the trade theories had to change its nature profoundly due to the ever-expanding pressure of globalisation. Thus they had to change from their static, short-run and localised context into new fields that would capture more elements of the universal **functional openness of trading nations**. On the other hand, as the gravity models of trade show, the functional openness has not been so far absolutely global. The exchanges among nations are not distributed evenly – they depend of the size of attraction and the "closeness". The strategic alliances are therefore also discriminatory and subject to coalition games.

The integrity of a small open country, as an authentic, prosperous and free society, can be often maintained only if there is a social consensus for a flexible adjustment subject to many compromises. Though transition may lead to long-term benefits, there are always present risks of costs, usually extremely high costs. We can posit that transition is a long-term trajectory from an original equilibrium to a new equilibrium that is challenged by costs in the reallocation of resources. We can recognise two stages of the process. First there are **costs of disintegration** of the old alignment and then there are **costs of achieving equilibrium in a new integration.** The former can be more painful than the latter because it comes as a sudden shock that reveals that a part of the existing resources has been allocated as **sunk costs**. It is the nature of sunk costs that they are so specific to their present usage that they are immobile. In case they are subject to import competition (or a general reallocation) their recoupment is very limited and such factors lose (Krugman, Obstfeld (1996, pp. 39-60). In the worse case their marginal efficiency is zero and such factors must be scrapped. The first stage of transition is reflected in the descending part of the well-known GDP's J-curve. The expectations are generally marked by destructive or redistributive outcomes.

On the other hand, the second stage is marked by the convergence to a new equilibrium. It is more gradual and it is accompanied by a recovery. Its costs, measured as a demand for new investment expenses, may remain again high. However, there the location of resources is accompanied by more productive expectations. At the same time it is not certain whether the new equilibrium will be associated with a higher level of welfare per capita. The only sure thing is that the distribution of gains and losses will not fall on all economic actors in a symmetric way. The trajectory of evolution from one equilibrium set-up of a nation to another one is definitely non-linear. The switchover between two different qualitative (institutional) arrangements in international exchanges is subject to uncertainty (as the theory of second best explains) and a temporary loss in social welfare that becomes a barrier to changes.

The magnitude of costs may depend not only on how much a new strategic partner (superpower) differs from the previous one, but also on whether the transition is mutually voluntary or forced. It also matters if the alignment converges to stability on grounds of a consensus for mutually beneficial productive co-operation or if the new relationship is guided by redistributive principles (rent seeking). It is the aim of the governments to assess the costs and benefits of transition. Cost is a typical economic category and, as such, its real format must be understood as an **opportunity cost**. For that purpose we have to juxtapose a given historical decision (which is deterministically "correct" ex post, and, in the short-run, irreversible and without feasible alternatives) with a **hypothetical alternative**. For example, we can compare a real event with a speculation of non-transiting or of transiting along a different trajectory.

One can have doubts that the transition of a small nation can be explained exclusively as a unilateral decision of a superpower or as a result of a game between superpowers. The active role of a small nation also matters for explaining how the process of alignment is undertaken and what the costs of the ensuing transition are. The ability of a small nation to co-operate, instead of resisting a bid for new political alignment, makes the transaction costs much lower and the probability of a successful transition higher. The transition of a small nation also implies costs on the side of a superpower because modern superpowers do not have full autonomy (Svetlicic (1997), p. 7). The impact of the transition of Eastern Germany on Western Germany (or even on the European Union) is a prime example. The reluctance of France to respond in economic exchanges to enormous political gains in Central Europe after the World War I is just another case. The **costs of alignment are so**

high that they matter to both partners.

Decisions concerning national alignments (e.g. decisions about military actions, political pacts, customs unions or economic integration) can be subject to outcomes, which can differ between the short-term and the long-term. They are often spontaneous and intuitive. The influence of a re-alignment on the respective society is so complex that it is very difficult to determine which potential outcome a particular policy can bring about. Even worse than that: there may arise confusions between ends and means because the objectives of control (social aims) and the agents controlling the instruments can hardly, given this complicated environment, satisfy the condition of independence. Therefore, both the non-transparency of cost-benefit analysis and the conflicts of interest may bring the social decision-making in transition to a failure or to a long-term misalignment. Resultant social disturbances and a loss of internal or international equilibrium of power can make the costs extremely high on all sides. The costs can be measured by losses in the potential GDP.

International alliance, co-operation and ensuing mutual insourcing, though absolutely essential for a small nation, are not exclusive sources of its development and progress. Actually they represent only the **exchange function** of a more complex mode of existence. **The exchanges are an effect of internal capacities of production**. External alignment, which is serving the exchange function, would have hardly anything to offer in the long-run without effective mechanisms of production. Though they are primarily described by economic production functions, their efficiency also depends on the institutional set-up: property rights, organisation of production, social networks for collective action, public administration and ethics of social conduct.

A global characteristics of the creative social function can be found in **entrepreneurship**. Here one should consider Baumol's (1990) hypothesis that entrepreneurship and its aim for creativity, profit or power is omnipresent in all societies. The problem is in which alternative economic fields (productive, unproductive or destructive), and under what internal conditions and incentives the entrepreneurship is allocated in the given period. The ensuing transition after external re-alignment can lead to such internal shocks that the entrepreneurial side of creation degenerates into redistribution and the collective action for stability gets paralysed (see Olson (1982)). The adverse outcome of this situation is that the exchanges of a new alignment can also degenerate into an unproductive partnership and hostility.

Since the exchanges under a given national alignment can be seen as too costly or unsatisfactory by at least one of the partners, conflicts between nations can occur very often. Their manifestation can be first visible in the rise of **ideology and internal political clashes**. Very often a duality of ideology can be observed: one which tries to overcome the problem and one which inflates the problem. This may even go as far as wishful thinking, illusions, delusions, lies and social paranoia. Nationalism, chauvinism, racism, religious hostility, class struggle and communism are just some specific reflections of local political encounters which signal that social systems have not been able to control certain alignments without conflicts.

Czechia is a unique testing ground for the mentioned behavioural patterns of small nations. Czech history full of multicultural and multinational contacts, the geographical position in the sphere of several superpowers, and the relative prosperity of the country - this all mixed together brought Czechs to the situation of becoming both subjects and objects in a multitude of interactions with superpowers. It is irrelevant if they chose or were just chosen for being players in various international coalitions. Our aim will be to study how a change in a strategic alignment of Czechia, as a small nation, generated a different pattern of institutional arrangements and different dynamics of economic development and growth.

The **methodology** of the second part of this study is historical, describing the evolution of external pressures and their impacts on domestic real adjustments, entrepreneurship and ideology. It will be shown that a change in the Czech strategic geopolitical orientation led always to unexpected and extensive reversals in both the economic performance and the social organisation of the nation. It is surprising that even though Czechs seem to be highly cautious and risk-averse, in cases of historical upturns they were able to take amazing risks, and later tolerate (or even actively adjust to) their adverse outcomes. The process of learning from history can be very slow since much information is lost in time between generations. Thus the old problems like to come back in a spiral. But the "**path dependency**" is a methodological approach that definitely has a descriptive interpretation that only commences in exchanges among nations and its adjustment processes. In its explanatory context it must become **inter-disciplinary** because the spectrum of problems carried over from the past is extremely wide.

Though the impact of globalisation is clearly transparent in the case of Czech Lands, at least since 1848, its advancement was challenged by numerous countermoves. A summary of historical events in the

Czech Lands interpreted here as a transition is indicated in Table 6.

B/ Historical Analysis of Czech External Alignments after 1848

Our study starts in the crucial year of 1848 when the Czech historical consciousness and national identity were revived and the Czechs felt themselves as objects in an alien alliance with the Austrian Empire. The Habsburg rule was imposed on Czech Lands forcibly in 1620 and the original Czech national existence based on Protestant faith was nearly obliterated. Czechs became well aware of the Central European tri-polar superpower set-up, which had been reinforced after the defeat of Napoleon. Czech leaders calculated first with three basic alternatives for future political and economic alliances: potential federalism under the "Habsburg yoke", Slavonic mutuality with the "Russian bear" or integration with the "German (Prussian) hawk".

Though at the Prague Slavonic Congress of 1848 Czech leaders declared their Slavonic allegiance, it had hardly any impact on Czech real (economic) adjustment to either a Polish (which in Czech modern history has never happened) or a Russian alliance. Practically it was only an impulse for a search of an alternative ideology to reveal their national exclusivity. The only important real alignment came with the Slovaks, who were at that time still in their pre-national stage and who found in Czechs a convenient ally. Even though it was already evident that the economic progress coming from Germany was more important than what Austria could offer, German centralist and nationalistic tendencies were found unacceptable. When F. Palacký was invited in 1848 by the Frankfurt National Committee to take part in German Parliament as a Czech representative, he refused prophetically: "Imagine Austria split into a multitude of little republics - what a fantastic ground for a universal Russian monarchy. If Austria did not exist, we would have to create her" (Palacký (1898, p. 19).

However, the German influence on Czech (Sudeten) Germans, who formed approximately 35% of inhabitants of the Czech Lands, was decisive. It was not in politics but in the economy and management. Czech Germans were industrially more advanced after 1750's than Czechs (see Seibt (1996), p. 195). Only after 1848 did Czechs realise that it would have to be their own and not the local ethnic German or Austrian economic prosperity that should finally decide about the balance of power in the Czech Lands. The competition and alignment with the local German element, that was orientated to the pan-German world, became the central issue of the Czech history for the next hundred years.

After the 1840s the Czech Lands were caught into a rivalry for economic dominance where on both sides (German and Czech) the frenzy for education, culture, journals, clubs and entrepreneurship became paramount. With these two national entities fighting for future national dominance, the Czech Lands gradually became much more similar to Germany than any other region in Central Europe. Although the benefits of economic convergence to Germany were visible in a sharply rising Czech prosperity, the process revealed its conflicting nature, reflected in growing nationalism and brawls for cultural dominance. The cult of Jan Hus, the radicalism of Hussites and the counterfeiting of historical "Manuscripts" were just few examples of a more far-reaching ideology subjecting Czech sub-consciousness: a "historical law" where Slavonic "doves" have to fight ceaselessly for freedom against German "hawks". It was presumed that, sooner or later, either Czechs or Sudeten Germans would have to close the breathtaking race by installing a one-sided political dominance. This was expected to result in a heavy cost imposed on the losing side.

The creation of Austria-Hungary in 1867 was a harsh blow to the ideas of Czech and Austrian co-existence under a balanced multinational federal state. New alignments were sought and in 1869 the first Czech bid to build a political bridge beyond Germany was proposed by L. Rieger to France. This political rapprochement grew in strength after 1871 (Birke (1960)) and gave Czechs an illusion that the local tri-polar superpower game can be outwitted to the Czech advantage by attracting in a fourth superpower.

Economic and cultural development in the Czech Lands during 1850-1912 can be described as extraordinary, comparable with the recent rise of new industrial countries (Pulpán (1993)). Though evidently belated and immature, if compared with England or Netherlands, the industrial potential of the Czech Lands with a fifth of the Austro-Hungarian population was most probably higher than in historical Austria. In 1910 40% of its labour were engaged in industry, while in Austria it was 32% (Teichova (1998)). Some historians claim that the Czech Lands covered at its peak of prosperity in 1912 nearly three quarters of the manufacturing production in the Empire (see Seibt (1996), p. 204) [1]. On the other hand, the technological and managerial know-how came nearly exclusively from the West, usually mediated first by Czech Germans and Jews. Even though Czechs were in their economic orientation converging undisputedly to the West, their philological (Slavonic) stigma, ideology stressing Eastern historical roots, and the impotence of Czech political parties to get a hearing in Vienna, located them somewhere in-between: to the provincial mezzo-Europe.

World War I was a turning point. While before the war the Czech right for national self-determination seldom deviated from ideas of political or fiscal federalism, the involvement of France, Britain and USA into the theatre of war and their expected influence on the design of future European order, changed dramatically the stakes to be won by Czechs. In late 1917 the defeat of Germany and Austria was probable and many Czech leaders bet on the future French hegemony. The bids for entering into new alliances proposed to Czechs by France, Britain, Italy and the USA were keenly reciprocated. The Slovak card in the hands of M. R. Stefánik and the Czech army of 120,000 men fighting against Germany, Austria and Red Army in the hands of T. G. Masaryk, helped persuade the soon-to-be victorious superpowers about the viability of their plans for the balkanisation of Central Europe. Though an extremely risky plan, the stake of a "deserved dominance" over the more than 3 million minority of Germans and liberation from "perfidious Habsburg rule" was pushing Czechs to take an active part in this venture.

The Inter-war Period

The policy of building a permanent political bridge over its closest neighbours - Germany, Austria and Hungary – looked to Czechs reliable during the whole of the 1920's. The Czechoslovak political alliance with France seemed to eliminate the German gravity, and the subsidiary alliance with Yugoslavia and Romania promised a new opportunity to stabilise the problematic mezzo-Europe. The Czechoslovak average annual growth of 5.2% for 1920-29 (see Pryor et al. (1971)) was interpreted by many as a firm ground for a pragmatic appeasement with Austria, Germany and Czech Germans.

The reality was, however, different. The demise of Austria-Hungary had more adverse impacts on the new-borne Czechoslovakia than did the world war itself. Czechoslovakia of 1918 found herself in a transition. Its costs can be estimated at a loss of GDP of at least 20% [2] in 1920 relative to 1912 (Prucha (1974)). The Czech economy was stricken by initial political instability, recession, losses on the majority of traditional markets, changes in ownership and the need to re-shape her infrastructure towards Slovakia and Ruthenia. Czechoslovakia recovered her peak GDP per capita of 1912 only in 1925 (Korbel (1977), p. 78). The real production in the Czech Lands in fact increased during 1913-1938 no more than by 40 % [3].

As a result of changed alignment, foreign trade gradually adjusted to a new centre of economic convergence. Tables 1 and 2 depict the development of Czech exports and imports by countries between the wars. The share of Austria and Hungary in exports dropped from 44.2% in 1920 to 9.2% in 1937. Germany soon replaced the losses: the share of exports to Germany rose from 12.7% in 1920 to 26.8% in 1928 and in imports from 24% to 38.6%. In 1928 the Sudeten German entrepreneurs were again leading the trade with the

[1] *The economic position of Czech Lands relative to Austria (in today's borders) before World War I is a highly controversial issue. Some authors claim that Czech Lands still lagged to some degree. A clear lead was in light industries only. Butschek and Prucha (1966) indicate a lag of 25% in GDP per capita. Other historians estimate that the Czech lag was only 5% (see Table 9). However, the main advantage of Czech Lands prior to 1914 was in high level of education, export openness and growth.*

[2] *Some authors claim a much higher loss due to transition, e.g. Toms (1966) assumes a decline of at least 40% in the period 1914-1923. Pulpán (1993, p. 415) quotes that the decline of the Czech industrial production in 1919 could be even more than 50%, mainly due to the post-war chaos. Unfortunately the literature is quite inconsistent in the interpretation of the development in that period.*

[3] *There is not a unanimous interpretation of the Czechoslovak inter-war growth. Clark (1957) estimated it for mere 25%, while Korbel (1977) and Pryor et al. (1971) claim a growth around 40%, and Aldcroft, Morewood (1995) even 46%. In all cases it should be noted that the economic performance of Czechoslovakia in 1922-38 was not worse than the average growth in the rest of developed Europe. In the GDP per capita the Czech Lands were still ahead of Austria and following Belgium and France (see Kaser, Radice (1985) or Butschek (1995)).*

West (see Pasold (1977) for an insightful literary description of this development).

After 1918, the Czech attitude to the creation of wealth changed, too, as the politics and culture opened extremely intensively to the West, while the Soviet Russia was taken for an enemy. Instead of a Slavonic folklore, the economic and cultural links with the whole world, integration with Slovakia and Ruthenia, and "hard daily work" became dominant. However, the land reform in order to restitute Czechs for expropriations in 1620 (!) and to punish conservative landowners (i.e. mainly German and Hungarian aristocracy and the Catholic Church), was not a good motive for hard productive work. Even though only a part of the plans were fulfilled after 17 years of negotiations, the incentive for becoming rich by redistribution and rent seeking opened a small but very dangerous precedence which loomed again in 1938, 1939, 1945, 1948, 1970, 1991 and 1993.

On the side of ideology, the unfortunate post-war policy of Czech and Slovak dominance over the local German "minority" was slowly subsiding [4]. Finally it was renounced by the Prime Minister A. Svehla in 1926. The Czech national reconciliation culminated in the 1929 elections when out of 66 German members of Parliament 51 belonged to the wing accepting active co-operation with the Czechoslovak state (Hilf (1996), p. 75). At that time it was widely accepted in the Czech ideology that the controversial dismantling of the Habsburg Empire was hard but a correct and necessary step from which all Czechoslovak citizens and Central Europe could benefit.

However, after the Great Crash of 1929 it was apparent that new international alignments, designed as bridges over former centres of attraction, were weak. They were more political and ideological than economic. The analysis of Czechoslovak trade flows during 1920-37 reveals that the role of France as an economic building block of the new political and cultural alliance in Central Europe was subsiding, becoming non-viable at the end. A similar attenuation could be observed in trade with Italy, Britain and the USA. After the rise of Nazism, the economic alignment with Germany became unbearable and new markets in the Balkans and overseas had to be sought. It became apparent that after the split of Austrian empire into non-co-operating small entities there was hardly any substitute to be found for the German market.

After the depression of 1930-35, with a decline in GDP of 18.2% (Nachtigal (1989), or Pryor et al. (1971)), industry plummeting by 41% (Aldcroft, Morewood (1995)) and with the ascent of Nazi Germany, the whole Czech success was shaken. Czech tariff incidence rate in 1931 rose to 50% (Drabek (1985, p. 263)) and the turnover of trade was steadily declining. In 1938 it reached only 30.1% of turnover in 1929. The losses in the trading ties with the West were quickly transferred into sharp losses in the overall Czechoslovak economic performance (Kosta (1999)), what had adverse impacts on the Czech political stability. All these combined adverse developments were slowly moving the whole Czechoslovak society to its worse national humiliation called "Munich". The position of Czech international politics was weakening so intensively that it failed even in securing an agreement with any of the neighbouring or formerly allied countries. The only country declaring to stand by Czechoslovakia was the Soviet Union. The Agreement on Mutual Help, signed with Stalin in 1935, was a desperate attempt, which could hardly offer any hope for optimism. One can only speculate what later influenced more the shocking reversal in Czech post-war outlook: the helplessness of Munich or the ordeal of German occupation.

Soon after the full take-over in 1939, the integration of the Czech Lands with Germany in production, management and institutional arrangements ran at an unparalleled speed. The totalitarian methods of commanding the Czech economy notwithstanding, the realignment after occupation resulted in a fall of production by 5% in 1941 relative to 1939 (Krejci, Machonin (1996)). The suppressed hostility of Czechs to Germans developed into a syndrome of hatred vindicated by alleged German inborn evil. At the same time the Western allies were often suspected of a lukewarm approach. Finally the Russians were accepted as moral victors and the Soviet Union as a future strategic partner. Neither Britain nor France (not to mention Germany) were considered superpowers offering a meaningful alignment. The West European space looked empty. This resulted in a post-war schizophrenia in external alignment and an ideology, which helped to keep it in a deadlock for 44 years. Even though one may be tempted to say that it was the agreement among the superpowers in Yalta and Potsdam that installed the Soviet control, it is a sad fact that the Czech society did hardly anything to challenge these arrangements.

[4] *For example, it was reflected in an idea that Sudeten Germans should be judged as "tolerated immigrants and colonists" and thus a state-forming role was not offered to them.*

The Developments Just after the World War II.

With her industry and infrastructure practically untouched by war [5] and with strong work ethic, the re-borne Czechoslovakia had optimal economic prospects for a new round of prosperity. The growth of production in 1946-48 was impressive and allowed the country to reach the pre-war level of GDP per capita in less than three years - much quicker than in the majority of countries in Europe. The loss of GDP in the period of 1945-46 is estimated around 15% (Toms (1966)). Surprisingly, the loss of 3 million Sudeten Germans in 1945-47 did not cause any serious crisis and the recovery proceeded very quickly.

With the GDP per capita being the highest among all nations in Central and Eastern Europe in 1948 (see Table 3 and estimates in Butschek (1995)) the Czech Lands were on par with many countries in Western Europe. The post-war spell of "new life" became so stupefying that nearly the whole Czech society, as can be judged from our present perspective, lost the sense of reality. The weirdest radical and irrevocable steps followed, nearly all of them far away from Czech historical experience (see also Feierabend (1996)).

Instead of stressing productive aspirations and trade links with advanced nations, the ideology turned to self-sufficiency, Slavonic fundamentalism, state capitalism and nationalisation. In 1947 only 30% of GDP were produced by the private sector. The incentives to redistribute property went in parallel with ethnic "final settlement" and retribution for Sudeten Germans' alleged high treason (Stanek (1996)). This bewitching programme found accord among nearly all Czechs and it was eagerly supported even by democratic parties.

The confidence in future economic prosperity and management was high, based on the belief that "we managed it before, we will manage it again". It was forgotten that "we" had changed its contents due to a new internal composition of inhabitants, new external alignment and new economic system. The consensus of "co-operating with all winning superpowers", while the alliance with the Soviet Union was taken for its eternal guarantee, was an attempt to build the future on economic convergence between capitalism and communism. This ideology of "the third way" was skilfully directed by the coalition government to a fatal convergence to the Soviet Union.

The loss of more than three million Sudeten Germans "transferred back home" to Germany and Austria, did not imply just a loss of a qualified labour and frittering away their property. It meant also a loss of those marginal voters who could keep the Communist Party out of the leadership in the coalition government in 1946. As a backfire after the expulsion, Czechs had to seek refuge against German "revenge" under the Soviet tutelage. In 1947 there was a light showing the way back from the dark. The participation in Marshall Plan was first agreed upon unanimously by all members of the government. Six days later the same government voted unanimously against it. The most awkward intervention by Stalin remained virtually unchallenged. The paralysis of the Czech democratic post-war political system was absolute - it was not even noticed that on 10th July 1947 another “Munich” had taken place. In February 1948 Czechoslovakia arrived (to a large extent democratically, as the only country in the world) under the Communist rule.

The resulting real adjustments to the Soviet economic, social and political model are well known. The redistribution of property (nationalisation, taxation and appropriation), as the main means of enrichment, was upgraded to a dominant motif of social creativity. In this context the Prague Spring of 1968 was bound to be more a timid call for a more diversified portfolio of political and cultural alignments (a return to the "third way") than a bid for a return to capitalism. It was destined to be a sort of an unsuccessful local variety of "goulash Communism" not showing signs of transition. In fact it brought a more important message for Russians (understood later by Gorbachev) than for the Czechs.

The Establishment of the Communist Legacy

The whole period of 1948-1989 was an economic disaster, even though there were some confusing successes on the volume side of production. For example, Czechoslovak physical capacities in such industries like steel, trucks, aircraft, arms, power-generation, cement, coal, oil refining, etc., were often more than comparable with economies of similar size throughout Western Europe. GDP per capita in 1984-91 was estimated between \$ 2400 (by using a market exchange rate for 1991) and \$ 9400 (by Summers and Heston

[5] *The Czech economy strengthened during the war period because of new investments into strategic industries like steel, metal-working and chemistry. The employment in manufacturing increased by 39% in 1945, relative to 1938 (see Teichova (1998), p. 136).*

(1988), in case of using the PPP estimates for 1985) [6]. If we take the range of $ 2600 - $ 6000 for a more plausible approximation of the Czech GDP per capita in 1991 and convert it into constant dollars (of US price level of 1938), then we can estimate its real growth from approximately $ 225 in 1948 to a spread of $ 255 through $ 588 in 1991. The maximal average growth rate during these 43 years of roaming astray in the Communist partnership was 2.6% per year [7]. The bottom estimate (which is more suitable in reflecting the potential of the Czech international competence) would be as low as 0.43%. The average annual growth of Austria (in constant dollars) was approximately 6.7% for the same period. In terms of international Dollars, the real measure of GDP per capita in the Czech Lands in 1991 was approximately 3.5-times less than in Austria which in 1948 was in a worse condition.

As it follows from the previous paragraph, there are two alternative ways how to compare economies, which are as different as Czechia and Austria: by using the current exchange rate and the PPP rate. Table 9 presents a summary for the international comparison of major economies in the world. If we compare the development between 1950-1996, the lag of Czech GDP per capita behind that of Austria was approximately 6-fold in 1996. If, however, we base the comparison on the PPP rate (instead of the market exchange rate) the Austrian lead becomes only 2-fold. Though the latter better reflects the internal Czech view on their standard of living, it grossly overvalues the actual potential of the Czech economy as an international partner (Benacek (1998)). Finally, the reconciling approach of Butschek (see Table 3) satisfies the rule of a golden mean. Thus, as a compromise, the lag of Czechia behind Austria (in GDP per capita) in 1998 can be estimated to be approximately 3-fold.

The story of the unfortunate Czech economic performance after 1948 can be stated even more dramatically. While, mainly due to competition with Germans and the co-operative alignment of Czechs with surrounding nations, the growth of the Czech economy in 1848-1912 and in 1921-1929 was in all cases a spectacular one, a much less favourable statement must be said about the developments in 1913-1920 and 1930-1993. Surprisingly, the cataclysmic period of 1930-1948 (which included such adverse events as the Great Crash, breakdown of ties with Nazi Germany, occupation, war losses, expulsion of Germans and large-scale nationalisation) was more successful in terms of economic growth than the lower estimate of growth in 1949-1991. The per capita growth rate in 1929-1948 from $ 202 to $ 225 is more than the growth from $ 225 to $ 235 during 1949-1991. Even in 1996, in the year of Czech economic stabilisation and growth, the estimates of GDP per capita (in nominal US $) in the Czech Lands were ranging between $ 4,700 and 10,800. They still could not compare with the range of $ 22,000 - 28,000 for Austria. The Czech trade performance shows a similar weakness. For example, Czech exports per capita in 1995 were 4.3 times less than those of Austria, being nearly as large as the per capita trade of Portugal (see Table 7).

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[6] *Methodological remark concerning international GDP comparisons:*
There is a catch in converting inter-temporal GDP data in different currency to a common currency in constant prices. The preferred approach is to use PPP equivalents, stressing the internal purchasing parity in consumer utility as a common denominator. On the other hand, the use of market exchange rates is targeted to a different aspect of comparisons - to an external purchasing parity related to efficiency of exchanges with abroad and competitiveness of trade. The results of both can be very different. For example, according to Maddison (1989) Austrian GDP per capita (on PPP rate) increased approximately 4-times in 1950-1987, while our figures (based on market exchange rate) would suggest an approximately 12-fold growth. In case of a small highly open economies the use of the latter is more meaningful for describing their potential. One should keep in mind, that less developed countries with a fast growth, accompanied by qualitative changes in their product mix, usually do not stick to the PPP patterns in the exchange rate development. Their currencies may turn quite suddenly from "undervalued" into "overvalued"by appreciating in real terms.

[7] *A similar estimate of 2.6% annual growth during 1951-1985 is indicated in Summers and Heston (1988). The estimate used by Good (1996) is 2.2% p.a. for 1950-1987, though this looks dubious because he assumed that in 1987 the standard of living in Czechoslovakia was only by 25% lower than in Austria. One may be tempted to base the Czech growth on figures of $225 for 1948 and $ 9400 for 1991(i.e. $922 in constant dollars). This would be methodologically incorrect because the former was calculated on commercial exchange rate and the latter on PPP rate. The estimate of Butschek ($ 6000 per capita for 1985) used also for 1991 would approach more the PPP rate estimate assessed on the Austrian basket of commodities.*

The Great Transition

Dismantling of the Communist rule in 1989 became a historical challenge for the Czechs. It was generally understood that it would require a return back to the roots. The phenomenal rise of small businesses in 1990-94 (Benácek (1997a)) was a signal that Czech capitalism had not been forgotten. This development, unorchestrated by any special government support, has remained until these days the most productive impulse for Czech capitalist transition. With the existence of the European Union it was much easier to find reliable alliances in the West than to approach individual partners and attempting to build new "Western bridges". The establishment of CEFTA, after a long Czech hesitation about whether a formal alignment with the "East" could be productive, was agreed upon in 1993. This became an important step in overcoming the trap of forming an economic vacuum in the East and the ensuing isolation, once it became clear that the Czech economic liberalism was just an empty rhetoric.

The transition of trade is depicted in Tables 4 and 5, and Figures 1 and 2. The toil of trade diversion, from its Eastern orientation before 1990, was terminated in mere five years. The geographic trade pattern in 1995 is not very different from the pattern in 1928. With German speaking countries scoring a 50% share on total Czech exports, there is no doubt about what is the centre of gravity of the Czech external economic orientation. A very similar picture can be given by analysing the inflows of foreign direct investment (Zemplinerová, Benácek (1997)).

The separation from Slovakia was originally looked upon by Czechs as a move for freeing their hands from an unsuccessful Eastern legacy and for concentrating on a speedy Western convergence. Surprisingly, this sacrifice brought hardly any advantage to the Czech economic scene. The opposite was true: the disintegration of Czechoslovakia was detrimental to both countries due to their shrinking market size and the rising transaction costs in their mutual trade. Also, by decreasing the domestic competition, the pressure for efficiency in both the Czech government and domestic firms declined. Thus the redistributional nature of entrepreneurship during 1938-1989 could be awaken. Large-scale privatisation combined with the existence of semi-private infant banks, unregulated investment funds, disorganised capital market and loopholes in legislation have again shown the way to redistribution as the main means of short-term prosperity. A sharply rising balance of trade deficit, which reached nearly 9% of GDP in 1996, and a slow growth of exports were signs that the Czech external exchanges were hit by frictions and rigidities on their supply side.

Having no serious problems with the collection of taxes, the government could keep fiscal expenditure high. If the income from privatisation, extraordinary revenues of the Czech National Bank and various quasi-fiscal receipts are added to the former, the redistributive burden of the state in 1996 was not much lower than in 1989 (Benácek (1997b)). It can be estimated that the share of public revenues on GDP in 1996 was at least 55%. This allowed the country to revive the idea of a socialist welfare state and build it firmly into the expectations of the majority of the population, big businesses, banks and politicians. With 75% of the GDP produced officially by the “non-state” sector in 1996, the Czech government was taken for a champion-to-be among the post-Communist countries. On the other hand, the hidden reality of a dysfunctional privatisation and its rent seeking (Benacek (2001b)) diverted the motives of managers from real adjustments. The power of the state-owned banks and many official and unofficial fiscal “pillows” allowed the majority of big firms in the hands of indigenous owners to postpone the restructuring or even to avert the threat of bankruptcy.

The shock from the 1996 Parliament election came too late. Czech transition in the corporate sector found its roots more in 1947 than in any other period. The original Czech idea to base the national creative aspirations on a pattern of fast-growing liberal economies, and become a European mutation of Asian Dragons, could not lift its roots from the post-war Europe. The real convergence to welfare state and semi-state capitalism in 1993-97 became the aim preferred not only by the Czech median voter and its political parties, but also by the allies in the European Union. The liberal rhetoric of the Czech government notwithstanding, there were revealed both internal and external barriers in attempting to convert the centrally-planned and totalitarian Czech society to a prosperous, quickly-growing market economy.

The transition, which commenced in 1989 by reversals in external alignment, changed the Czech Communist society practically in all aspects. No one can deny that alliances after the fall of Communism commenced a convergence to West European patterns of a standard social behaviour. The cost of transition, represented by a cumulative GDP loss of approximately 22% in 1993 definitely did not reflect all social costs. One should consider the extent of opportunity costs. By that we mean benefits lost due to failures in building institutions and establishing policies supporting productive entrepreneurship, as an alternative to the proliferation of redistributive or destructive activities. The slow growth after the stabilisation in 1993-95 was also an effect of the unsolved frictions in the society.

Let us therefore look at the problem of Czech catching-up. Once we may agree that historical path-dependency is important for the long-run development, we can search for the "natural" (traditional) partners for the economic and cultural alignment of the Czech society. We found that in the past the success was primarily associated with the co-operation with Austria and Germany. There could have been found also strong links with Slovakia, and, to a lesser extent, with Slovenia, Croatia, Netherlands and Switzerland. All OECD countries from this south-west connection have been very successful in their development in the last 50 years and their GDP per capita is incomparable with the present Czech level. Table 9 presents a historical overview in a time-span of 1913-1996 how the Czech GDP per capita ranked with other countries.

The condescending path of the Czech economy after 1948 is not reflected by Table 9 in a sufficiently wide context because there are not included all countries that overtook the Czech economy after 1950. While until 1950 the Czech economy ranked 11th - 14th among all countries in the world (with the exclusion of New Zealand and some miniature countries, like Luxembourg, Liechtenstein, etc., for which there are no data available), in 1999 she ranked officially 65th, or 52nd on commercial or PPP exchange rates, respectively. For example, in 1999 (in GDP per capita at commercial exchange rate) Czechia was overtaken (among others) by Argentina (55th), Uruguay and Saudi Arabia and closely followed by Chile, Hungary (68th) and Brazil. The ranking at PPP changed the ranking as follows: Czechia was overtaken by Slovenia (47th), Korea and Greece, and followed by Argentina (56th), Chile and Malaysia.

Another indicator expressing the losing relative position of the Czech economy after 1948 is the relationship of the Czech GDP per capita to OECD average (see last row in Table 9). While during the period of 1913-1950 her level was 73-85% of the average, in 1999 it was 50% - if measured at the internal purchasing power parity. However, if we measure the GDP per capita at the external purchasing power, her level was at mere 20%. Though the standard of living is better estimated from the PPP figures, the low ranking at the commercial exchange rate simply shows that Czechia had serious problems with the adjustment of her domestic production and trade to the demand on world markets throughout 1990s. The divergence between the commercial and PPP Dollar values demonstrates the problems in the international competitiveness of both the Czech exports and the domestic import-replacement production.

Table 10 presents an alternative for international comparison of the GDP growth per capita in 1996. Data from Table 9 have been converted into constant dollars of 1980. The rates of growth for 1950-1996 on commercial exchange rate in column 7 are orientational. Methodologically they are biased because the statistics for 1950 were estimated on exchange rates that were neither purely commercial equilibrium rates nor mutually consistent PPP. Their message is that the European OECD countries grew faster than average and their real exchange appreciated at the same time. The Balassa-Samuelson effect thus biased the growth rate in commercial dollars to higher growth rates, relative to the rates achieved by planned economies. The latter countries are on the tail of the sample (unsurprisingly following the Argentinean leadership) and their lag in the competitiveness of foreign trade and the participation in the international co-operation were menacingly widening until the mid 1990s. The growth based on the PPP rates depicts better the internal developments - especially in the standard of living. Nevertheless, even in this methodology the planned economies show an unsatisfactory performance. In comparison with her two Western neighbouring countries - Austria and Germany - the Czech economy grew at less than a half speed.

The Problems of Catching-up

The path of catch-up with such European economies like Austria, Finland, Norway or Italy, once in the past on a par with the Czech economy, will be a very difficult one. Damages caused to the Czech economy by 41 years of isolation from the world markets and the legacy of alignments with countries with too different institutional arrangements than was the Czech tradition until 1948, has revealed to be a burden too heavy for an easy and quick dismantling. The majority of post-Communist economies are economies with neither a fast nor an steady growth. The period of revival after a partial adjustment was often exposed to a new round of adjustments and new hardships. The countries, which represent an appropriate match to the Czech economy in the catch-up scenario even in a long-run, are Slovenia, Greece and Portugal. In a more optimistic case, Spain can be also considered as a target in a super-long-run.

Table 7 shows that the degree of openness of the Czech economy of 63% is higher than the intensity revealed for Austria and far beyond the measure for Portugal or Greece. It is exceedingly wide, if we compare it with its low GDP per capita. Especially the import absorption seems to be beyond expected limits. Thus the wide openness of the Czech economy does not offer much space for further manoeuvring in the direction of increasing the volume of trade on Czech GDP. The catching-up with the wealthier countries must thus be accompanied with a balanced growth in the whole domestic economy. This growth should be driven by significant changes in the quality of domestic production that would be reflected in rising unit-prices in exports and improved terms of trade. The advances in export competitiveness must be accompanied by advances in the domestic import substitution. It also implies that the main role for the catching-up rests to a large extent on the improvements in human capital. Such a strategy of development is related with the appreciation of the real exchange rate (Benacek (2001)) and the narrowing between the GDP in commercial and PPP dollars.

Table 8 attempts to present three scenarios of Czech growth aimed at catching-up with three more advanced economies: Portugal, Spain and Austria. The catch-up model is not based on the PPP levels of development, since this internal concept does not reflect sufficiently the problems of external alignments, efficiency of trade and thus the equilibrium level of exchange rate. Once international comparisons are based on free market exchange rate the path of real appreciation of the domestic currency (in which the GDP is measured) becomes also a relevant indicator for development. This is in accord with a hypothesis formulated by Halpern and Wyplosz (1997) that the real appreciation is an autonomous impact on the development of the real side of the economy.

In constructing our scenario we have chosen the GDP per capita in 1999 as the base year for the future development converted to USD at the commercial exchange rate. The growth rates of Portugal, Spain and Austria are indicated in the lower half of Table 8, column 3. We have assumed that their average real growth for the last 8 years will continue in the future [8]. We have considered three scenarios of growth for Czechia:

A (super-optimistic), B (highly optimistic) and C (moderate). The model is defined as follows:

$$(Y/N)_T^{/\$/} = (Y/N)_0^{/Kc/} / R_0 {*} e^{(g+r)*t} \qquad \text{where:}$$

Y/N is the GDP per capita in given currency,
$, Kc mark the currencies (USD and Koruna) for the GDP values,
R_0 is the market exchange rate of Kc/$ in the base period 0,
e is the base of natural logarithm,
g is the real annual growth rate of GDP in domestic constant prices,
r is the annual growth rate of real exchange rate appreciation relative to USD,
t = 0, 1, 2, …, T is the index of time (in years) starting with 0 in 1990.

It is assumed for Spain and Austria that their GDP will grow only in real terms and their real exchange rate would remain constant. According to the super-optimistic scenario A, the catch-up with Austria can be expected in 2024. However, with the much more realistic scenario C we should wait until 2044 or later. To catch-up with Portugal, with which the race on the PPP level looks quite close, would require to wait until 2012, but in case of a slightly less successful Czech growth the same may last even until 2027.

While the gap between Czechia and the countries of OECD has been widening during 1948-1991, the process of catching-up estimated in Table 8 looks surprisingly slow. Most probably the way back to the previous position in the world economy will take more than 43 years during which the gap was developing. On top of the problems mounting during 1948-1989, one may be tempted to put a question if the transformation strategy adopted was not an additional burden that would cause another negative hysteresis effect precluding the recovery. Actually the GDP gap between Czechia and Austria has been further widening during 1990-2000. In the Czech case it cannot be said that the mode of its transition adopted after 1989 was forced from the outside. That means, it was not introduced against the Czech will and for the advantage of external powers. Adventurous privatisation strategy, often purposefully orchestrated loopholes in the legislation, dubious corporate governance, failures in the enforcement of law, bureaucracy, and

[8] *The following growth rates were assumed, as taken from the World Bank statistics: Austria 2.2%, Spain 2.9% and Portugal 3.2%.*

intransparent collusion between politics, big businesses and public administration – these all in a negative synergy caused unexpected detrimental impacts on the long-term social and political stability and growth. Lack of productive creativity and unsolved restructuring of large firms privatised by "mass privatisation techniques", which still provide approximately 40 % of GDP, may for long have negative spillovers not only on the environment of the whole domestic economy, but also on the efficiency of exchanges with the European Union.

Though the unique task of reaching a global solution of the problem of external alignment of the whole Central Europe with the EU need not be threatened, the costs of transition may be socially less acceptable than what some optimists expected on both sides. The resultant convergence to EU might lead to a prolonged relationship of an unequal partnership. The strong bias for redistributive coalitions and rent-seeking at the expense of productive motives in the Czech Republic, if unsolved, could undermine seriously her efficiency in economic adjustments and may lead to conserving an unstable periphery at the Eastern flank of the future enlarged European Union. The growing resistance of the EU countries to the Eastern enlargement forms a different threat. The most important impact of enlargement on EU is expected on the labour market. Though the increased competition and the pressure for imposing a discipline on the inflated West European wages and the welfare state public spending are without doubt advantages supporting sagging international EU's competitiveness, the general public takes it as an attack on its economic security. Combined with other open agendas, such as CAP, voting rights, structural funds and monetary union, the enlargement may be suddenly challenged from the EU side. Then both the pan-European adjustment to the world economy and the accession countries' full-fledged adjustment to the EU may be put at stake.

Fortunately, there is some positive news behind the 2-years of Czech economic stagnation of 1997-99. The expectations of an easy growthmanship, the low unemployment rate, the bottomless pocket of the public finance, the endless bailout capacities of the commercial banks, the reliance on easy monetary policy for patching the holes in restructuring – those now no longer constitute a political option that would be feasible in vying for a political support. It is neither the liberal rhetoric nor the populist promises of the welfare state that will bring the politicians higher credibility. The introduction of functioning legislation and the property right enforcement are generally accepted as an inexorable duty. The sale of all banks to foreign strategic partners became a nationally accepted policy. The foreign direct investment is generally seen as the only reliable strategy for growth. Surprisingly, the foreign investors have also found recently that their presence in the Czech economy may be valuable. The FDI inflows in 1999-2001 are expected to be over 15 billion USD. With that, the Czech economy will become already before the expected entry into EU in 2004 an economy with over 50% of GDP produced by quickly growing firms owned by foreign capital.

It is at the grass roots from where the efficiency has been spreading into the Czech economy in the last five years. The contents of human capital embodied in the production has been growing since 1997 (Zemplinerova, Benacek (1999)). The reliance on education and the build-up of human capital, as a long-run policy that has no alternatives, has been gaining recently an attention among the industrial policy-makers. The biggest problem of the country, however, remains still embedded in its hierarchies. Firstly, it is the inefficient, corrupt and bureaucratic public sector that needs a fundamental shakeout. Unfortunately, because of the accumulated power in that sector, no weak government will be able to bring the public sector and the government services to a condition where hard budget would drive them to restructuring. Both the public servants and the politicians still remain united in a strategy that the state means an exercise of power over the public and not a service to the public. The immaturity of the local democracy and the lack of sense for a functioning civil society are a liability coming from the legacy of the totalitarian past. These challenges were re-appearing in the Central and East European context for the whole 20th century. In the Czech environment it became a tradition that their internal solution was either postponed or suppressed. The equilibrium was then installed by an external power. The Czech alignment with the EU is unavoidable. But neither the EU nor Germany are now behaving like a traditional superpower eager for dominance. Though seemingly episodic, the sudden Czech revival in that matter can become a catalyst shaping a non-trivial part of the European dynamics. An opposite move, for example to a continuation of internal strife, can cause lasting misalignments. The costs of their repercussions may not be borne only locally but also to a large extent internationally.

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Table 1: Czechoslovak Exports before World War II
Foreign Trade in 1920, 1928 and 1937 in millions of current US $ estimated at official exchange rate

Country	1920	1928	1937	Shares % 1920	Shares % 1928	Shares % 1937
Germany	41	172	62	12.7	26.8	15.0
Austria	113	95	30	35.1	14.7	7.3
France	28	9	16	8.6	1.4	3.8
Italy	15	25	14	4.7	3.8	3.4
Britain	9	45	36	3.0	7.0	8.7
Other West Europe	26	61	68	8.1	9.5	16.5
USA	6	35	38	2.0	5.5	9.3
OECD	240	449	273	74.8	69.9	66.2
Hungary	29	44	8	9.1	6.9	1.9
Poland	17	26	11	5.2	4.1	2.6
Balkan countries	21	66	50	6.6	10.2	12.2
USSR+Baltic	2	9	4	0.5	1.4	0.9
Eastern Europe	69	146	73	21.4	22.7	17.6
Rest of world	12	48	67	3.8	7.5	16.2
Total	321	643	413	100.0	100.0	100.0

Source: Historical Statistical Yearbook. FSÚ, Praha, SNTL, 1985, p. 853
Estimated GDP in current prices (converted to US $, in millions) was approximately $ 872 in 1920, $ 1982 in 1928 and $ 2069 in 1937.
Export/GDP ratio was approximately 37% in 1920, 33% in 1928 and 20% in 1937.
The exchange rate to US $ was: 86 Kc in 1920, 33 Kc in 1928 and 29 Kc in 1937.

Table 2: Czechoslovak Imports before World War II

Foreign Trade in 1920, 1928 and 1937 in millions of current US $ estimated at official exchange rate prices at official exchange rate

Country	1920	1928	1937	Shares % 1920	Shares % 1928	Shares % 1937
Germany	65	225	66	24.0	38.6	17.3
Austria	35	44	16	13.0	7.5	4.2
France	11	25	20	4.1	4.3	5.3
Italy	12	19	9	4.3	3.3	2.4
Britain	12	25	24	4.3	4.3	6.3
Other West Europe	43	48	62	15.9	8.3	16.5
USA	48	35	33	17.6	6.0	8.8
OECD	229	429	236	84.1	73.6	62.4
Hungary	8	26	6	2.8	4.4	1.5
Poland	5	38	10	1.7	6.6	2.5
Balkan countries	8	34	41	3.1	5.8	10.8
USSR+Baltic	2	6	5	0.7	1.1	1.3
Eastern Europe	23	105	61	8.3	18.0	16.1
Rest of world	21	49	81	7.7	8.4	21.5
Total	272	582	379	100.0	100.0	100.0

Source: Historical Statistical Yearbook. FSÚ, Praha, SNTL, 1985, p. 854

Import/GDP ratio was approximately 31% in 1920, 29% in 1928 and 18% in 1937.

Table 3: Comparison of GDP per capita in 1938-1995
Estimates by using official exchange rates of the local currency or estimates based on purchasing power parity (for Czechoslovakia, Hungary and Poland in 1975 and 1985).
Values are in USD current prices, if not indicated otherwise.

Year	U S A	Austria	Czecho-Slovakia	Hungary	Poland
1938 a Butschek [f]	521	179	176 (206[r])	112	104
1948 a Butschek [k]	683	130	195 (225[r])	98	141
1975 b Dlouhý	7,176	5,010	4,015	3,559	3,598
1985 a Butschek	16,494	10,729	6,000	5,062	3,977
1985 c Summers	16,494	11,710	9,401	8,272	6,268
1991 d IMF	22,653	22,125	2,396	3,210	2,030
1991 in USD of 1938[ek]	2,221	2,170	235	315	199
Real rate of growth 1948-1991 p.a.	2.7%	6.5%	0.43 % 2.6 % [p]	2.7% 3.8%[p]	0.80% 2.4%[p]
1995 d IMF	27,590	28,900	4,565 [r]	4,040	2,800
Annual growth (GDP in **nominal** USD) 1991-95	4.9%	6.7%	16.1%	5.7%	8.0%

Sources:
a - Butschek F. (1995)
b - Dlouhý V. (1987)
c - Summers R., Heston A. (1988) and Pick M. (1990)
d - current IMF statistics of GDP in current prices adjusted by average market exchange rate

Remarks:
[e] - adjusted by using implicit index of price deflator for the US GDP 1938 - 1991 of 10.2, as estimated from the Economic Report of the President. Washington, 1991
[f] - remark: estimates of GDP in US $ per capita in 1938 for other countries according to Butschek (1995)):
Britain 378, France 235, Belgium 275, Italy 127, Norway 255, Finland 178, Greece 80
[k] - at constant prices of 1938.
[p] - growth rate 1948-1991 based on purchasing power parity estimates by using data provided by Butschek (1995), as indicated for 1985, and converted to constant USD of 1938.
[r] - Czech Republic (or Czech Lands) only.

Figure 4: Geography of Czech imports in the period 1989-1999

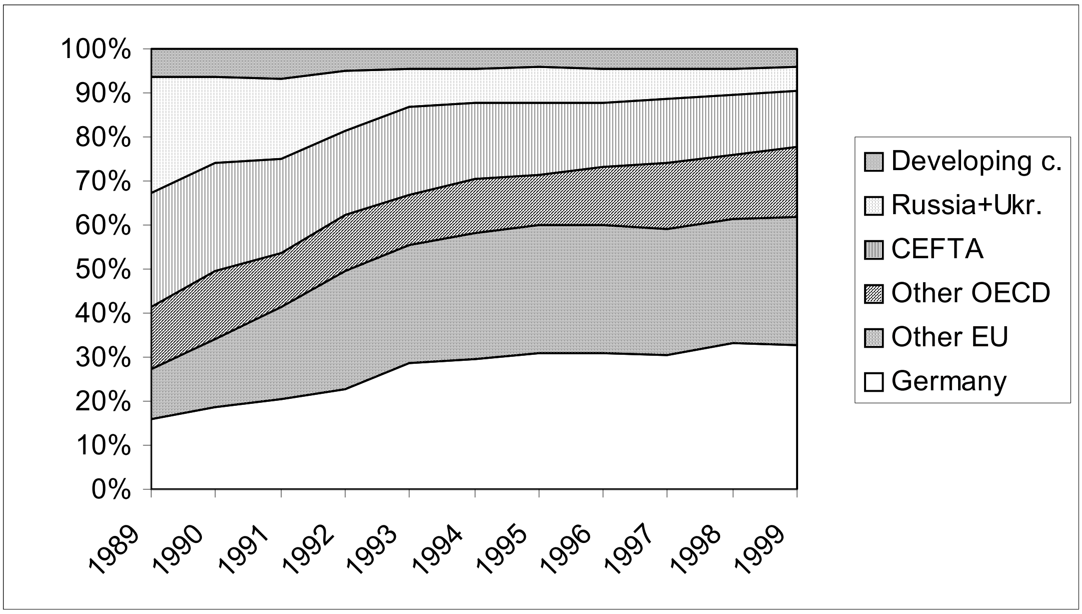
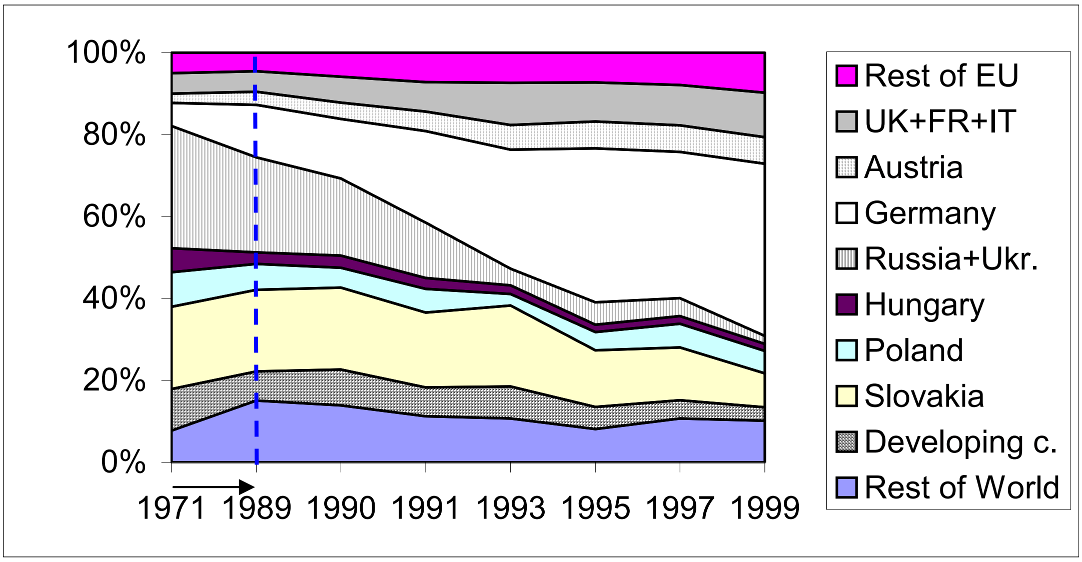


Table 5: Geography of Czech exports in the period 1971-1999



Sources for figure 1 and 2: Trade statistics, Czech Statistical Office, 1973, 1994 and 2000

Table 6: Review of Historical Events in Czechia Considered as a Transition

Period	Event	Impact on GDP
1918-1920	World War I and break-up of Austrian Empire	Decline by -20% or more
1929-1935	The Great Crash and militarisation of the economy due to a threat from Germany	Decline by -18%
1939-1941	Occupation and integration with Germany	Decline by –5%
1945-1946	World War II recovery, expulsion of Sudeten Germans and nationalisation	Decline by -15%
1948-1963	Stalinism, central planning and colectivisation	Incessant problems with supplies and persistent loss of competitiveness in exports
1990-1992	Intensive transformation	Decline by -22%
1993-1994	Partition of Slovakia	Stagnation

Table 7: International Comparison of the Intensity of Czech International Trade (including services) in 1999

Country	Exports (X) in $ bil	Imports (M) in $ bil	Population (mil)	GDP per capita in $	(X+M)/2 per capita in $	Degree of openness *
Czechia	33,2	34,0	10,2	5146	3263	63,4 %
Hungary (1998)	23,8	24,8	10,1	4658	2406	51,6 %
Greece	25,1	35,7	10,6	11776	2871	24,3 %
Portugal	33,8	45,5	10,0	11326	3970	35,0 %
Spain	165,1	169,4	39,4	15115	4245	28,1 %
Ireland	81,8	68,9	3,75	25246	20372	80,6 %
Belgium	190,7	181,1	10,2	24562	18316	74,5 %
Austria	94,4	95,0	8,20	25466	11550	45,3 %

Source: International Statistics. IMF Yearbook. IMF, Washington, 2000
* The degree of openness is calculated as: (X + M) / 2 / GDP.

Table 8 : Scenarios of the Czech GDP per capita (P/C) growth in 2000-2008 and the year of catching-up GDP values are in USD, constant prices of 1999

COUNTRY SCENARIO	GDP P/C IN 1999	ANNUAL GROWTH RATE IN %	GDP P/C IN 2008	CATCH-UP IN YEAR
Czechia A	$ 5060	5% real GDP + 3.8% CZK exchange rate real appreciation	$ 11,172 Czech	Austria 2024 Spain 2016 Portugal 2012
Czechia B	$ 5060	4% real GDP + 3% CZK exchange rate real appreciation	$ 9,501 Czech	Austria 2033 Spain 2024 Portugal 2018
Czechia C	$ 5060	3% real GDP + 2.8% CZK exchange rate real appreciation	$ 8,528 Czech	Austria 2044 Spain 2034 Portugal 2027
Portugal	$ 10,600	3.2% real GDP	$ 14,138 Portuguese	CZ A 2012 CZ B 2018 CZ C 2027
Spain	$ 14,000	2.9% real GDP	$ 18,175 Spanish	CZ A 2016 CZ B 2024 CZ C 2034
Austria	$ 24,970	2.4% real	$ 31,656 Austrian	CZ A 2024 CZ B 2033 CZ C 2044

Source of data for 1999: World Bank: World Development Report 2000/2001. Washington, 2001
For a comparison of scenarios see:
Sachs J., Warner A.: Achieving Rapid Growth in the Transition Economies of Central Europe. Discussion Paper 544, Harvard Inst. for Int. Development, Cambridge, USA, July, 1996
Pinto B., Ramakrishnan U.: Wage Convergence to Western Levels: How Soon? Transition, The World Bank, No. 1, 1996

Table 9: International Comparison of GDP Per Capita in US $

Years 1913, 1929 and 1950 are in constant US $ at prices of 1980; 1938, 1996 and 1999 are in current prices)

Country	1913	Rank	1929	Rank	1938	Rank	1950	Rank	1996 CER	Rank	1996 PPP	Rank	1999 CER	Rank	1999 PPP	Rank	Change 1913-99	Change 1950-99
USA	3772	1	4909	1	521	1	6697	1	28020	7	28020	1	30600	5	30600	1	0	0
Switzerland	2474	5	3672	2	367	5	4589	3	44350	1	26340	2	38350	1	27486	2	3	1
Norway	1573	18	2184	12	255	11	3436	10	34510	3	23220	4	32880	2	26522	3	15	7
Denmark	2246	8	2913	7	316	9	3895	6	32100	4	22120	6	32030	4	24280	4	4	2
Belgium	2406	6	2882	8	275$^{>}$	10	3114	11	26440	8	22390	5	24510	9	24200	5	1	6
Japan	795	23	1162	23	112	23	1116	23	40940	2	23420	3	32230	3	24041	6	17	17
Austria	1985	9	2118	14	179	15	2123	17	28110	6	21650	7	25970	6	23808	7	2	10
Canada	2773	4	3286	4	377	4	4822	2	19020	16	21380	9	19320	16	23725	8	-4	-6
Netherl.	2400	7	3373	3	323	8	3554	8	25940	10	20850	11	24320	10	23052	9	-2	-1
Australia	3390	2	3146	6	380	2	4389	4	20090	13	19870	14	20050	14	22448	10	-8	-6
Germany	1907	11	2153	13	354	6	2508	15	28870	5	21110	10	25350	7	22404	11	0	4
France	1934	10	2629	9	236$^{>}$	13	3038	12	26270	9	21510	8	23480	12	21897	12	-2	0
Finland	1295	20	1667	18	178	16	2613	14	23240	12	18260	16	23780	11	21209	13	7	1
Britain-UK	3065	3	3200	5	378$^{>}$	3	4164	5	19600	15	19960	12	22640	13	20883	14	-11	-9
Sweden	1792	13	2242	10	327$^{>}$	7	3874	7	25710	11	18770	15	25040	8	20824	15	-2	-8
Italy	1773	14	2089	15	167	18	2104	18	19880	14	19890	13	19710	15	20751	16	-2	2
Ireland	1680	16	1900	17	252	12	3450	9	17110	17	16750	17	19160	17	19180	17	-1	-8
Spain	1590	17	1620	19	132	21	1683	22	14350	18	15290	18	14000	18	16730	18	-1	4
Czechia	**1890**	**12**	**2205**	**11**	**206**	**14**	**2909**	**13**	**4740**	**20**	**10870**	**19**	**5060**	**20**	**12289**	**19**	-7	-6
Argentina	1770	15	2036	16	172	17	2324	16	8380	19	9530	20	7600	19	11324	20	-5	-4
Hungary	**1340**	**19**	**1598**	**20**	**141**	**19**	**1847**	**19**	**4340**	**21**	**6730**	**22**	**4650**	**21**	**10479**	**21**	-2	-2
Slovakia	**1075**	**21**	**1375**	**21**	**138**	**20**	**1785**	**21**	**3410**	**22**	**7460**	**21**	**3590**	**23**	**9811**	**22**	-1	-1
Poland	**810**	**22**	**1360**	**22**	**128**	**22**	**1827**	**20**	**3230**	**23**	**6000**	**23**	**3960**	**22**	**7894**	**23**	-1	-3
OECD countries	2224	50 *%	2727	57 *%	282	51 *%	3553	57 *%	25870	14 *%	22390	32 *%	25730	16 *%	24430	38 *%	Change in ranking	

Sources for Table 9: see the next page

Sources for Table 9:

Years 1913 and 1929 : Maddison (1989),
year 1938 : UN (1949), Kaser, Radice (1985), p. 532, Butschek (1995) and Solimano (1993), p.14,
year 1950 : Good (1996), Butschek (1995) and Maddison (1989)
year 1996 : The World Bank (1998)
year 1999: The World Bank (2001)

CER = values in current US $ at Commercial Exchange Rates
PPP = values in international US $ at Purchasing Power Parity rate
> = some sources indicate higher value
* = GDP per capita of Poland, Czechia, Slovakia and Hungary (with the population used as weights) as a percentage of GDP per capita for OECD countries

Sources for Table 10:

Year 1950: Good (1996), Butschek (1995) and Maddison (1989); Year 1996: World Bank (1998)

Deflator index of US Dollar for 1980-1996 (1.816), for adjusting the current prices of 1996 to constant prices of 1980, is taken from US DC (1998), Table C1.

Table 10: Growth of GDP per Capita in 1950-1996 - An International Comparison
All data for GDP are in constant prices, i.e. in constant US $ at prices of 1980)
(CER = commercial exchange rate; PPP = purchasing power parity rate)

Country	Rank in 1996 (at PPP)	1950 const. prices	1996 CER const. p.	1996 PPP const. p.	1950-96 CER growth in %	Rank in growth CER	1950-96 PPP growth in %	Rank in growth PPP	Net contribution of nominal growth to total growth at CER
USA	1	6697	15430	15430	1.81	17	1.81	18	0
Switzerland	2	4589	24422	14504	3.63	5	2.50	11	1.13
Japan	3	1116	22544	12896	6.53	1	5.32	1	1.21
Norway	4	3436	19003	12786	3.72	4	2.86	9	0.86
Belgium	5	3114	14559	12329	3.35	10	2.99	6	0.36
Denmark	6	3895	17676	12181	3.29	11	2.48	12	0.81
Austria	7	2123	15479	11922	4.32	2	3.75	2	0.57
France	8	3038	14466	11845	3.39	8	2.96	7	0.43
Canada	9	4822	10474	11773	1.69	18	1.94	17	-0.25
Germany	10	2508	15898	11624	4.01	3	3.33	5	0.68
Netherlands	11	3554	14284	11481	3.02	12	2.55	10	0.47
Britain (UK)	12	4164	10793	10991	2.07	15	2.11	15	-0.04
Italy	13	2104	10947	10953	3.59	6	3.59	3	0
Australia	14	4389	11063	10942	2.01	16	1.99	16	0.02
Sweden	15	3874	14157	10336	2.82	13	2.13	14	0.69
Finland	16	2613	12797	10055	3.45	7	2.93	8	0.52
Ireland	17	3450	9422	9224	2.18	14	2.14	13	0.04
Spain	18	1683	7902	8420	3.36	9	3.50	4	-0.14
Czechia	**19**	**2909**	**2610**	**5986**	**-0.24**	**23**	**1.57**	**21**	**-1.81**
Argentina	20	2324	4615	5248	1.49	19	1.77	20	-0.28
Slovakia	**21**	**1785**	**1878**	**4108**	**0.11**	**21**	**1.81**	**19**	**-1.7**
Hungary	**22**	**1847**	**2390**	**3706**	**0.56**	**20**	**1.51**	**22**	**-0.95**
Poland	**23**	**1827**	**1779**	**3304**	**-0.06**	**22**	**1.29**	**23**	**-1.35**
OECD	5b	3553	14246	12329	3.02	11 b	2.70	9 b	0.32

Sources: see the previous page