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

HISTORY OF CZECH ECONOMIC AND POLITICAL ALIGNMENTS VIEWED AS A TRANSITION

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1. INTRODUCTION

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 outlined by North (1990). A radical change of this kind entails a transition to new equilibria in such characteristics like ownership, exchange, organisations, dominant economic agents and incentives. In this paper, transition will be associated with a long-run path of change in the economic system caused by the dislocations in:

- domestic markets and international trade,
- previous allocation of resources,
- the stability of previous structures of ownership, and
- political and economic alignments.

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 gain economically if it opens up and builds its development through foreign exchanges based on comparative advantages. In the process of specialisation, a small nation can gain per capita much 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 only limited 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 co-existence 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 the alignment of a small nation from one to another superpower is felt in the small nation as a discontinuity.**

Small nations can seldom generate internally all conditions necessary for their modern economic, social, cultural and political development. Without the deployment of ideas and

resources of the whole world their economic wealth and growth would be much lower. Although a change in the strategic geopolitical orientation of a small nation may commence with a seemingly innocent platonic curiosity "to look for inspiration elsewhere", it may finally lead to falling under the attraction of an alternative superpower and the country may end up with **real adjustments** going through all structures of its society: changes in the organisation of production processes, markets, trade, ownership, 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 a leading socio-economic entity. 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 economics of small countries rests in their higher sensitivity to trade, external shocks, adjustment and restructuring (Damijan (this volume), Bellak and Cantwell (1997)). Though transition may lead gradually to long-term benefits, risks of costs, usually extremely high costs, are always present. First there are the **costs of disintegration from** an old alignment, associated with an abrupt destruction of immobile resources inefficiently allocated under the new circumstances, and then there are **costs of the build-up of new integration**. A large part of the costs are sunk costs and transaction costs which are usually disregarded in traditional economic theories. It is our aim to assess the costs and the 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 when 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 always implies costs on the side of a superpower because modern superpowers do not have full autonomy. 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 adjust economically to enormous political gains in Eastern Europe after World War I is just another case. The **costs of alignment are so high that they matter to both partners**.

International alliance, co-operation and ensuing mutual in-sourcing, 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 setting: property rights, organisation of production, social networks for collective action, public administration and ethics of social conduct.

A global characteristic 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 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.

The Czech Lands are a unique testing ground for the mentioned behavioural patterns of small nations. Their history full of multicultural and multinational contacts, geographical position in the sphere of several superpowers, and their relative prosperity has often brought Czechs to a situation in which they became both subjects and objects in a multitude of interactions with superpowers.

Our aim will be to study how a change in the strategic alignment of Czechia, as a small nation, has generated a different pattern of institutional arrangements and different dynamics of economic development and growth. A summary of historical events in the Czech Lands interpreted here as a transition is presented in Table 1.

2. HISTORICAL ANALYSIS OF CZECH EXTERNAL ALIGNMENTS IN 1848 – 1998

2.1 From Prague Slavonic Congress (1848) until the World War I

Our study starts in the crucial year of 1848 when the Czech historical consciousness and national identity were revived and the Czechs regarded 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 power 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".

Although at the Prague Slavonic Congress of 1848 Czech leaders declared their Slavonic allegiance, it hardly had any impact on Czech real (economic) adjustment to either a Polish (which in Czech modern history has never happened) or a Russian alliance. 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 totally unacceptable for the Czechs. Thus they stood by Austria both economically and politically.

However, the German influence on Czech (Sudeten) Germans, who formed approximately 35% of the inhabitants of the Czech Lands, was decisive. It was not in politics but in the economy and management. Czech Germans were after the 1750s industrially more advanced than Czechs (see Seibt, 1996:195). 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 the balance of power in the Czech Lands. The competition and alignment with the local German element, which was oriented to the pan-German world, became the central issue of Czech history for the next hundred years.

After the 1840s, the Czech Lands were caught up in 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 with Germany were visible in sharply rising Czech prosperity, the process revealed its conflicting nature, reflected in growing nationalism and brawls for cultural dominance. 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 for 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 over Germany to France was proposed by L. Rieger. This political rapprochement grew in strength after 1871 (Birke (1960)) and gave Czechs an illusion that the local tri-polar superpower game could be outwitted to the Czech advantage by attracting a fourth superpower.

Economic and cultural development in the Czech Lands during 1850-1912 can be described as an extraordinary success (Pulpán (1993)). Though evidently belated and immature, if compared with England, the industrial potential of the Czech Lands with a fifth of the Austro-Hungarian population covered at its peak of prosperity in 1912 nearly three-quarters of industrial production of the monarchy (see Seibt, 1996:204). Even though Czechs were in their economic orientation converging undisputedly to the West, their Eastern philological stigma and ideology stressing Slavonic historical roots located them politically somewhere in-between: to the provincial Mitteleuropa. The stability of this arrangement was soon to be challenged.

2.2 From World War I until the World WarII

World War I was a turning point. While before the war Czech plans for national self-determination seldom deviated from ideas of political or fiscal federalism, the involvement of France, Britain and USA in 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 future French hegemony. The bids for entering into new alliances proposed to Czechs by France, Britain, Italy and the USA were keenly reciprocated. The appearance of an unexpected but relatively strong new partner in the troubled Central Europe helped persuade the soon-to-be victorious superpowers of the viability of their plans for finding a new equilibrium in this part of 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" pushed Czechs into taking an active part in this venture.

The policy of building a permanent political bridge over Germany, Austria and Hungary looked solid during the whole of the 1920s. 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 mezzio-Europe. The Czechoslovak average annual growth of 5.2% for 1920-29 (see Pryor et al., 1971:41) was interpreted by many as a firm basis for a pragmatic appeasement with Austria, Germany and the Czech Germans.

The reality was, however, different. The demise of Austria-Hungary had more adverse impacts on new-borne Czechoslovakia than did the world war itself. Czechoslovakia of 1918 found itself in a transition. Its costs can be estimated as a loss of GDP of at least 20%¹ in 1920 relative to 1912 (Prucha (1974)). The Czech economy was stricken by initial political instability, recession, losses in the majority of traditional markets, changes in ownership and the need to re-shape her infrastructure towards Slovakia and Ruthenia. Czechoslovakia recovered its GDP-per-capita peak of 1912 only in 1925 (Korbel, 1977:78). The real production in the Czech Lands in fact increased during 1913-1938 approximately by only 40%².

As a result of changed alignment, foreign trade gradually adjusted to a new centre of economic convergence: 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 the second half of the 1920s, Sudeten German entrepreneurs were again the leaders in trade with Germany (see Pasold (1977)).

After 1918, the Czech attitude to the creation of wealth changed, too, as the politics and culture opened to the West and Soviet Russia was taken for an enemy. Instead of a Slavonic folklore, the economic and cultural links with the whole world and "hard daily work" became dominant. However, the land reform in order to retribute Czechs for expropriations in 1620 (!) and to punish conservative landowners (i.e. mainly German and Hungarian aristocracy and the Catholic church), was no good motive for hard productive work. Even though only a small 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 1994.

The post-war Czech ideology that Sudeten Germans should be judged as "tolerated immigrants and colonists" was slowly subsiding and it was renounced 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, 1996:75). At that time, it was widely accepted in world politics that the controversial dismantling of the Habsburg Empire was a hard but correct and necessary step from which all Czechoslovak citizens and 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 new political and cultural alliances in Central Europe was subsiding and non-viable at the end. After the rise of Nazism, the economic alignment with Germany became unbearable and new markets in Western Europe and overseas had to be sought, what was very costly. The share of Czech exports in GDP fell from 33% in 1928 to 20% in 1937. It became apparent that, after the split of the Austrian empire into non-cooperating 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), Pryor et al. (1971)), with industry plummeting by 41% (Aldcroft and Morewood (1995)), and with the ascent of Hitler, the whole Czech success was shaken. The Western alignment was slowly heading to Munich and Czechs failed even in securing an agreement with Poland, which was facing the same geopolitical threat. 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 that could hardly offer any hope for optimism.

Soon after the full take-over in 1939, the humiliating integration of the Czech Lands with Germany in production, management and institutional arrangements ran at 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 and 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 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 that 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 Czech society did hardly anything to challenge these arrangements.

2.2 Economic decline after the World War II

With its industry and infrastructure practically untouched by war and with a 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 its pre-war level of GDP per capita in less than three years - much quicker than in the majority of countries in Europe. The fall in GDP in the period of 1945-46 is estimated at 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 highest among all nations in Central and Eastern Europe after the war, the Czech Lands were on a par with many countries in Western Europe. In GDP per capita in 1948 Czechia still ranked 13th just after Belgium and France, and before Finland, Germany and Austria.³ The post-war spell of "new freedom" became so stupefying that nearly the whole Czech society, as can be judged from our present perspective, lost its sense of political reality. The weirdest radical and irrevocable steps followed one after another, nearly all of them far away from Czech historical experience (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 was produced by the private sector. The incentives to redistribute property were parallel to ethnic "final settlement" and retribution for Sudeten Germans' alleged high treason (Stanek (1996)). This bewitching programme found accord among nearly all Czechs and was eagerly supported even by democratic parties.

The confidence in future economic prosperity was high and it was assumed that the success of the 1920s would be repeated. It was not noticed that the conditions had changed profoundly in the meantime: the composition of inhabitants, the external alignment and the economic and political systems. 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 Communists in the 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, meant not only a loss of a qualified labour and the frittering away of their property, but also a loss of those marginal voters who could keep the Communist Party out of leadership in the coalition government of 1946. It would also avoid to seek refuge against German "revenge" under the Soviet tutelage. In 1947 there was a light showing the way back from the dark. Taking part in Marshall Plan negotiations was agreed upon unanimously by all members of the government. Six days later, after a rude intervention by Stalin, the same government voted unanimously against it. The paralysis of the Czech democratic post-war political system was nearly absolute. In February 1948, Czechoslovakia arrived (to a large extent democratically, as the only country in Europe) 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 real transition. In fact, it brought a more important message for the Russians (understood later by Gorbachev) than for the Czechs.

The whole period of 1948-1989 was an economic disaster, even though there were some confusing successes on the volume side of production, such as in steel, trucks, aircraft, arms, electricity, cement, coal, oil refining, shoes, etc. The GDP per capita in 1984-91 can be estimated between USD 2500, by using a market exchange rate for 1991, and USD 9400. The later estimate is by Summers and Heston (1988) for 1985 and reflects purchasing power parity (PPP). One can have doubts about the meaning of both figures. If we take USD 6000, as estimated by Butschek (1995), as the most plausible approximation of 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 USD 225 per capita in 1948 to USD 588 in 1991. The average annual growth during Czech's 43 years of roaming astray in the Communist partnership was thus a maximum of 2.6%.⁴ The bottom estimate of the growth rate during 1948-91, based on commercial exchange rates (which are more suitable in reflecting international competence), would be as low as 0.43%.

As follows from the previous paragraph, there are two alternative ways for comparing economies institutionally as different as Czechia and Austria: by using the current exchange rate and the PPP rate. Table 2 presents a summary for the international comparison of countries during 1913-1996. The rise of such small countries as Switzerland, Norway, Belgium, Denmark and Austria looks phenomenal, especially in comparison of similar small countries like Czechia, Hungary and Slovakia.

If we compare the development between 1950-1996, the lag of Czech GDP per capita behind that of Austria was approximately sixfold in 1996. If, however, we base the comparison on the PPP rate (instead of the market exchange rate), the Austrian lead becomes only twofold. Though the latter better reflects the internal Czech view of their standard of living, it grossly overvalues the actual potential of the Czech economy as an international partner (Benacek (1998)). The external purchasing power of the Czech economy remained still quite weak in 1997, notwithstanding the phenomenal growth of its trade during 1991-97. Its exports of goods and services in 1997 were USD 2900 per capita, meanwhile those of Austria were nearly USD 13,000. Finally, if one were to take a reconciling approach and apply the rule of the golden mean of the above so divergent findings, the lag of the Czech economic potential

behind that of Austria in 1998 can be estimated to be approximately threefold in the per capita estimation. The cases of Austria and Czechia are an illustration of the economic gains and losses caused by convenient versus inconvenient economic and political alignments. Otherwise, one has problems in explaining why Austria was in a worse economic condition than Czechia during the whole period of 1924-1948 and accelerated so quickly thereafter.

The story of the disastrous 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 can be given about the developments in 1913-1920 and 1930-1991. 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 the retention of the external economic potential vis-à-vis the other developed countries than the developments in 1949-1991. Even in 1996, in the year of Czech economic stabilisation and growth, the estimates of GDP per capita (in nominal USD) in the Czech Lands ranged between USD 4,700 and USD 11,000 (see Table 2), which still could not compare with the range of USD 22,000 – USD 28,000 for Austria.

2.3 Economic and political transition in 1989-1998

The dismantling of 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 1990-92 (Benáček (1996)) was a signal that Czech capitalism had not been forgotten. This development, unorchestrated by any special government support, today remains 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 build new alignments separately with each country. The establishment of CEFTA, after long Czech hesitation about whether a formal alignment with the "East" could be productive, was agreed on in 1993. This has become important in overcoming the trap of leaving an economic vacuum in the East.

The transition of Czech foreign trade, by diverting its flows from the East to the West, was completed already in 1994. The geographic trade pattern in 1995 is not very different from the pattern in 1928. With German-speaking countries scoring a 50% share of total Czech exports, there is no doubt about what the centre of gravity of the Czech external economic orientation is. A very similar picture can be given by analysing the inflows of foreign direct investment (Zemplerová, Benáček (1997)).

Czechs originally looked upon the separation from Slovakia as a move to free their hands from a totally unsuccessful Eastern legacy and to concentrate on a speedy Western convergence. Surprisingly, this sacrifice has given hardly any advantage to the Czech political scene. The opposite is true: the disintegration of Czechoslovakia was detrimental to both countries due to their shrinking market size and increasing transaction costs in their mutual trade. Also, by decreasing the domestic Czecho-Slovak competition, the pressure for efficiency in both the Czech government and domestic firms has declined. Thus, the redistributive nature of entrepreneurship felt during 1938-1989 was able to be awakened. Large-scale privatisation, combined with the existence of semi-state 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 are signs that the Czech external exchanges were hit by frictions and rigidities on their supply side.

The shock from the political shift to the left in 1996 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 functions on a pattern of fast-growing liberal economies and become a European mutation of Asian Dragons could not lift its roots from post-war Europe. The real convergence to welfare state and state capitalism seemed to prevail among the public. The Czech economy in 1998, after 9 years of transition, remained in many aspects still non-standard. Nevertheless, the transition, which commenced in 1989 by reversals in external alignment, has changed the Czech society in practically all aspects. No one can deny that new alliances after the fall of Communism commenced a convergence to West European patterns. The cost of transition is represented by a GDP loss of approximately 22% in 1993 relative to 1989. The slow growth after stabilisation in 1993-95 is also an effect of the unsolved frictions in society.

Let us therefore look at the problem of Czechoslovakia's potential catching-up. Once we agree that historical path-dependency is important to long-run development, we can search for the "natural" (traditional) partners for the economic and cultural alignment of Czech society. We found that in the past success was primarily associated with the co-operation with Austria and Germany. One could also find strong links with Slovakia, and, to a lesser extent, with Slovenia, Croatia, the Netherlands, Switzerland, Britain, France and Italy. 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, as can be seen from Table 2 .

The descending path of the Czech economy after 1948 is not reflected by Table 2 in a sufficiently wide context because all countries which overtook the Czech economy after 1950 are not included. Whereas before 1950 the Czech economy ranked 11th - 14th among all countries in the world, in 1996 it ranked 30th, or 29th on commercial or PPP exchange rates, respectively. For example, in 1996 (in GDP per capita at commercial exchange rate) Czechia was overtaken (among others) by Argentina (27th), Uruguay and Chile and closely followed by Brazil, Malaysia and Hungary (33rd). The ranking at PPP changed the ranking as follows: Czechia was overtaken by Greece (26th), Slovenia and Chile, and followed by Malaysia, Saudi Arabia and Argentina (32nd).

The path of catch-up with European economies such as Austria, Finland, Norway or Italy, once in the past on a par with the Czech economy, will be very difficult. Damages caused by 40 years of isolation from world markets and alignment with countries with too different institutional arrangements than was the Czech tradition until 1948, has proven to be a burden too heavy for the emerging Czech market economy to dismantle in a short time. Post-communist economies have not yet been growing fast. Countries which represent an appropriate target for the catch-up in the long run are Greece and Portugal. The scenario for a Czech catch-up with Portugal, with which the race on the PPP level looks quite close (in the GDP per capita Portugal leads by 24%), may not be so easy, because the gap at the commercial exchange rate widens to a Portuguese lead by 114 %. Thus, the real appreciation of the exchange rate, and with it the rise in the efficiency of Czech exports, are also demanding tasks.

While the gap between Czechia and the OECD countries grew quickly during the 40 years of Communist rule, the process of catching-up, taken from the perspective of slow growth during 1992-98, offers little reason for optimism. One should not be surprised if the way

“back” to the Austrian level takes Czechs another 40 years. But perhaps even this is too optimistic. The institutional legacy inherited from a long-lasting alignment with non-market economies may be felt in Czechia for generations. Problems with property rights, dubious ownership transfers, failures in the enforcement of law, bureaucratic public administration and ensuing social tension may have unexpected detrimental impacts on Czech long-term social and political stability and growth.

Though the unique task of reaching a global solution to the problem of external alignment of the whole Central Europe with the EU cannot be disputed, the costs of its transition may be much higher than expected and the resultant convergence to the EU might lead to a prolonged relationship of unequal partners. The unsolved strong bias for redistributive coalitions and rent-seeking at the expense of productive motives in the countries in transition could seriously undermine their efficiency in economic exchanges and may lead to conserving an underdeveloped periphery at the Eastern border of the future enlarged European Union.

3. SUMMARY

This article aims to show, in the political economy framework, that a change in an external alignment (integration) of a small country involves a causal link to its economic and social dynamics. International partnership, co-operation and trade of a small country are interpreted as key factors determining a country’s social functioning and economic performance. An attempt is made to defend a hypothesis that current transition in the post-Communist Europe is not such a unique phenomenon in human history as often presumed. It is demonstrated in the case of Czechoslovakia that in this century there were several occasions when the social and economic shake-up was not dissimilar to recent painful economic developments. While it is well known that accumulated gains from a gradually proceeding economic alignment (integration) can be significant, there are much fewer studies about the abrupt national losses from disintegration of such an alignment. Czech economic history can be used to illustrate how the development of a nation can be influenced by both contingencies that do not act symmetrically.

ANNEX 1

Table 1. Review of Historical Events in Czechia Considered as a Transition

Period	Event	Impact on GDP
1914-1920	World War I and break-up of Austrian Empire	Decline by -20% up to -40%
1929-1935	The Great Crash and militarisation of the economy due to threat from Germany	Decline by -18%
1939-1941	Forced realignment 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 collectivisation	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 2. International Comparison of GDP Per Capita
(1913, 1929 and 1950 in constant USD at 1980 prices, 1938 and 1996 are in current prices)

Country	1913	Rank	1929	Rank	1938	Rank	1950	Rank	1996 CER	Rank	1996 PPP	Rank
USA	3772	1	4909	1	521	1	6697	1	28020	7	28020	1
Switzerland	2474	5	3672	2	367	5	4589	3	44350	1	26340	2
Japan	795	23	1162	23	112	23	1116	23	40940	2	23420	3
Norway	1573	18	2184	12	255	11	3436	10	34510	3	23220	4
Belgium	2406	6	2882	8	275 ^{>}	10	3114	11	26440	8	22390	5
Denmark	2246	8	2913	7	316	9	3895	6	32100	4	22120	6
Austria	1985	9	2118	14	179	15	2123	17	28110	6	21650	7
France	1934	10	2629	9	236 ^{>}	13	3038	12	26270	9	21510	8
Canada	2773	4	3286	4	377	4	4822	2	19020	16	21380	9
Germany	1907	11	2153	13	354	6	2508	15	28870	5	21110	10
Netherlands	2400	7	3373	3	323	8	3554	8	25940	10	20850	11
Britain (UK)	3065	3	3200	5	378 ^{>}	3	4164	5	19600	15	19960	12
Italy	1773	14	2089	15	167	18	2104	18	19880	14	19890	13
Australia	3390	2	3146	6	380	2	4389	4	20090	13	19870	14
Sweden	1792	13	2242	10	327 ^{>}	7	3874	7	25710	11	18770	15
Finland	1295	20	1667	18	178	16	2613	14	23240	12	18260	16
Ireland	1680 ^e	16	1900 ^e	17	252	12	3450	9	17110	17	16750	17
Spain	1590	17	1620	19	132	21	1683	22	14350	18	15290	18
Czech Lands	1890^a	12	2205	11	206	14	2909	13	4740	20	10870	19
Argentina	1770	15	2036	16	172	17	2324	16	8380	19	9530	20

Country	1913	Rank	1929	Rank	1938	Rank	1950	Rank	1996 CER	Rank	1996 PPP	Rank
Slovakia	1075	21	1375	21	138 ^e	20	1785	21	3410	22	7460	21
Hungary	1340	19	1598	20	141	19	1847	19	4340	21	6730	22
Poland	810	22	1360 ^e	22	128	22	1827	20	3230	23	6000	23
Czecho- slovakia ^b	1634	16 b	2038	15 b	176	16 b	2510	14 b	4260	21b	9500	20b
OECD countries	2224	85% ^{cz}	2727	81% ^{cz}	282	73% ^{cz}	3553	82% ^{cz}	25870	18% ^{cz}	22390	49% ^{cz}

Sources: 1913 and 1929 : Maddison (1989), 1938 : UN (1949), Kaser, Radice (1985), Butschek (1995) and Solimano (1993), 1950 : Good (1996), Butschek (1995) and Maddison (1989) 1996 : World Bank (1998)

CER = values in current USD at commercial exchange rates

PPP = values in international USD at purchasing power parity rate

a = Good (1996) and Maddison (1989) indicate a lower figure for the Czech Lands (USD 1738 after adjustment from data in 1910)

b = Czechoslovakia does not count as a country due to a separate inclusion of Czech Lands and Slovakia

e = own estimate by using alternative statistics

> = some sources indicate higher value

cz = GDP per capita of Czechia (=Czech Lands) as a percentage of GDP per capita for OECD countries (without Mexico)

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NOTES

- ¹ Some authors claim a much higher loss due to transition, e.g. Aldcroft and Morewood (1995) claim a drop by 30.2% in 1921 relative to 1913, Toms (1966) assumes a fall by at least 40% in the period 1914-1923. Pulpán (1993:415) quotes that the decline of the Czech industrial production in 1919 could have been even around 50%, mainly due to the post-war chaos.
- ² There is not a unanimous interpretation of the Czechoslovak inter-war growth. Clark (1957) estimated it at a mere 25%, while Korbel (1977) and Pryor et al. (1971) claim growth of around 40%, and Aldcroft and Morewood (1995) even 46%. In all cases, it should be noted that the economic performance of Czechoslovakia in 1922-38 was no worse than the average growth in the rest of developed Europe (see Kaser and Radice (1985) or Butschek (1995)).
- ³ For international comparisons, see Maddison (1989), Butschek (1992) or Good (1996)).
- ⁴ An identical 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.