Big Bang vs. Gradualism

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BIG BANG VS. GRADUALISM

Lauren Sims

Which method of transitioning is the most successful? A comparison of selected macroeconomic issues in the Czech Republic and Hungary attempts to find the answer, and lays the foundation for understanding how Central European Economies fit into the EU model.

THE CZECH REPUBLIC AND HUNGARY

Although Central European Economies (CEEs) had political systems that were heavily influenced by the same source, namely the Soviet Union and its brand of socialism, their transitions to market structures following the collapse of communism were markedly different. While some pursued “shock therapy,” others attempted a smoother transition by choosing a more gradual approach, which sometimes integrated reforms previously adopted during socialism. Despite different methods, CEE countries shared common setbacks, the most notable being high levels of inflation (in Western terms) and recession. Is a gradual approach more beneficial than a “big-bang?” A comparison between Hungary and the Czech Republic, which opted for gradualism and shock therapy respectively, suggests that both have advantages and disadvantages, but that neither is necessarily superior. Such a conclusion can be drawn from inspection of the major differences in their privatization, taxation, and exchange rate/monetary policies. Although both countries attacked the problem of transition in different ways, Hungary and the Czech Republic, along with the rest of the Central European countries recently inducted into the European Union, face tremendous hurdles to a successful financial EU integration and adoption of the euro.

The argument over whether gradualism or shock therapy is “better” for a transitioning economy has become an increasingly contested issue as statistical results of the 1990s wide-scale conversions are released and reevaluated. The transition of an economy generally occurs simultaneously with a change in political structure, as was the case for CEE countries following the collapse of communism in the early 1990s. For purposes of this paper, the transitional process involves not only the change of capital from state to private hands, but also the reconfiguration of all economic institutions that affect the freedom of markets,
namely those relating to monetary policy and state regulations, so as to conform to the Western model. Gradualism attempts to achieve this through small economic changes over time, which are strategically measured to diminish fallout from inflationary pressures and unemployment. To obtain the same outcomes, shock therapy attempts to transform all policies simultaneously. Both camps generally believe that the other is inefficient and will result in significant unemployment and inflation. Statistical analysis has been difficult in providing a clear winner, especially as "the sources, coverage, and quality of macroeconomic data in transition economies have varied dramatically over the past decade" (Filer & Hanousek, 2002, p. 226).

**POLITICAL CLIMATES**

Hungary’s political climate was strikingly different from many other CEE economies prior to 1989. Its Communist party possessed a strong reform wing that had been able to effect changes from the 1950s until the fall of the party at the end of the 1980s. Unfortunately, reforms made prior to the 1980s were largely reversed by the Hungarian government’s “policies of illusion” that quashed previous market-oriented restructuring in favor of a more protectionist Central Plan in response to the external impacts of the 1970s oil shock (Hare et al., 1992, p. 230). Despite this setback, the reform wing was able to establish lasting capitalist changes to Hungary’s economy in the 1980s. Perhaps the most significant alteration of the era was the development of a “second economy,” which arose due to the legalization of small-scale businesses in various sectors in 1981 (Hare et al., 1002, p. 229-33). In 1990, estimates placed industrial output of privately held small firms at 10 percent of the entire country (234). These businesses increased social tensions between those who remained on state incomes and “people with the right skills to earn high incomes” and/or enough wealth to become entrepreneurs (229). With the advent of these newly profitable companies, the government was forced to develop a better tax system and in 1988, alongside price liberalization, the personal income tax (PIT) and value added tax (VAT) were created (233-235). Hungary already had fleeting market experience with taxes in the past, when in 1968 the New Economic Mechanism allowed for industry (rather than state) control of some firms, producing profits that needed to be assessed and redistributed by the government (235). These new initiatives were “aimed at shifting the revenue burden from enterprise profits taxation to point-of-sale and personal income taxes, and closing the array of loopholes that fostered particularistic bargaining” (Bartlett, 1996, p. 61). In 1980, Hungary was one of the first CEE countries to have undergone price reform, which unfortunately led to declining terms of trade and increased inflation. This in turn negatively affected Hungary’s national debt (Bartlett, 1996, p. 54). Finally, business formation received a boost with the introduction of the 1988 Enterprise Law, under which “new firms became limited liability companies” (Hare, Revesz, Aven, Oblath, & Hans-Werner, 1992, p. 234). Ultimately the creation of the ‘second economy’ was only a flirtation with an actual market structure, and Hall’s report in 1989 that “there was no bankruptcy rate to speak of in Hungary” indicates that soft-budget constraints fostered by the Socialist leniency were still a major source of inefficiency (Hall, 1989, p. 476). While economic reforms were much more complicated than presented here, these examples serve to establish that, in stark contrast to countries like Czechoslovakia, Hungary had more than a decade of prior practice with markets before they began complete economic and political transition in the 1990s. This period gave Hungarian politicians experience necessary to conceptualize the ultimate goals.
of transition and to enact measures over time to gradually shift the Hungarian economic institutions.

Like Hungary, Czechoslovakia's political climate following the Velvet Revolution was dissimilar from other CEE countries. Tensions between Slovakia and the Czech Lands (Bohemia and Moravia) ran high after different experiences with the socialist structure. When the regions were combined in 1918 to establish Czechoslovakia, Slovakia accounted for 23 percent of the population, but contributed a mere 8 percent and 12 percent of industrial income and total national income respectively. Being already industrialized, the Czech Lands received the majority of foreign investment, and the distribution of income between the regions remained almost unchanged until the Second World War, when Germany began to increase the productivity of Slovakia for military advantage (Capek & Sazama, 1993, pp. 212-13). Following the war, the installation of a CPE (centrally planned economy) lead to the further development of Slovakian industry, causing industry output to rise to 68 percent of total Slovak production by 1989 (Capek & Sazama, 1993, p. 214). Rapid growth was largely the result of the redistribution of capital for industrial investment from the Czech Lands to Slovak Lands, allowing the Slovak economy to come close to parity with its counterpart (Slovak production in 1989 realized 30.4 percent of the Czechoslovak GDP for 33.7 percent of the population) (Capek, 1993, pp. 215-18; Hilde, 1999, p. 648). By analyzing these statistics, it is no surprise that Slovakia was content with the socialist government and preferred to approach economic reform after 1989 in a cautious manner. While the Czech Lands experienced growth during the same period, the results were much more reserved, causing Czech citizens to overwhelmingly demand aggressive economic reforms to combat the relative stagnancy of the last several decades (Capek & Sazama, 1993, p. 218). Although there were other nationalist and symbolic cleavages between both areas, a major impetus for the break in 1993 was economic irreconcilability felt on both sides. This sentiment is well-surmised by Slovak Prime Minister Carnogurský's statement that "Slovakia simply want[ed] to tackle its economic problems by making its own decisions" (Hilde, 1999, p. 657).

The political climates of both countries are important to recognize for a few key reasons. First, the stagnancy of Czechoslovakian industrial growth concurrent with massive industrial growth in Slovakia via centrally planned investment redistribution serves as an indicator that the Czech Republic$^2$ was "a stalwart example of traditional central planning until 1989" (Brom, 1994, p. 894). This is in direct contrast to the Hungarian environment, where forward-thinking politicians and economists implemented market-oriented reforms when it was apparent that the CPE structure was not indefinitely sustainable. While Hungary's reforms had already begun, the Czech Republic had to start from scratch both politically and economically following the Velvet Revolution. Each country also experienced relatively peaceful conversions politically (Munck, 1997), which is not necessarily the case for all transitioning economies around the world. However, the nature of the individual relationships between each country and the U.S.S.R. were very different, as instanced by the eventual occupation of the Czech Republic by Soviet forces in 1968, while Hungary experienced a small amount of leniency (e.g. its ability to enact capitalist-based structural legislation throughout communist rule). It is important to note that the issues surrounding these countries are specific to the Czech and Hungarian cases, and that such a comparison between gradual and "shock therapy" countries may not be universally applicable to other CEE states. Conclusions may be drawn from the following comparisons.
between privatization, tax regulation, and exchange rate and monetary policies that indicate certain advantages to each method.

**Privatization and Bank Bailouts**

Hungarian privatization in the 1990s was preceded by changes that occurred in the early 1980s. Small-scale firms were allowed beginning in 1981, and the program was greatly extended with the Law on Economic Association in 1988, which called for the selling of state-owned industries at fair value prices to both foreign and domestic interests (O'Toole, 1994, pp. 500-501). In fact, foreign buyers were encouraged “because of the lack of capital and capital markets” available to Hungary at the time (O'Toole, 1994, p. 501). Gray surmises that domestic investors were often difficult to procure because of the information deficit surrounding the condition of the industries for sale, whereas foreign investors were willing to take risks (Gray, 1996, p. 185). To attract buyers, the Hungarian government could arrange for the purchase of firms through installments, but this meant more risk to the government as inflation and management issues sometimes led to the inability of the purchaser to produce enough profits to pay up (Gray, 1996, p. 185). The Hungarian government opted to relinquish major control of the share selling/distribution process to the state property agency (SPA) which was “charged both with facilitating the sale of state properties and monitoring transactions to ensure fair prices and a minimum of insider deals” and which was also supposed to monitor workers’ interests and unemployment to prevent major instability (O'Toole, 1994, pp. 501-503). SPA made some efforts to reform the privatization process, which included preprivatization for conversion of smaller firms through fewer steps, active privatization for large firms, and self-privatization in which “reasonably sized[ed firms] could] select private consulting firms to assist them in fulfilling the legal requirements of the privatization process and arrange a scale” (504).

Although Hungary has been one of the most successful countries to transition via direct sales (in 1995, 40 percent by value of Hungarian firms had been sold to outside owners) (Gray, 1996, p. 184), the method was not unproblematic. First, the inability of some installment-based purchasers to repay the government caused difficulty in the banking sector and ultimately shrank the availability of credit (Gray). “Re-nationalizing’ firms was not an option because it would have been too complicated, and therefore businesses facing bankruptcy either had to be bailed out by the government or fail. Furthermore, the process of direct sales is expensive and slow because of the need to evaluate each offer individually, as well as to monitor whether the industry is performing acceptably afterward (in terms of workers’ rights and unemployment) (Gray, 1996, p. 185). According to Campbell, the government revenues from privatization by 1993 were an underwhelming one-third of the budget deficit, which reduced the hope that the deficit could be cured by direct sale privatization (Campbell, 1996, pp. 61-62). The situation was further complicated by corruption within the privatization institutions, namely the SPA and managerial sector. O'Toole notes the ability for managers of state-held firms to “take advantage of central weakness and opportunities in the law to convert public assets into private gain,” and there were also complaints over the SPA’s slow pace due to “bureaucratic overregulation” (502).

For a country with pre-market experience (from 1980’s reforms), it is somewhat surprising that the First Program of privatization in 1990 was “viewed by all concerned as a failure.” Subsequently, the Second in 1991 was only slightly more successful, with the government losing $72.3 million per month in 1992 to companies that failed to be privatized through
either program (O’Toole, 1994, p. 508).

The Czech model for privatization was very different from the Hungarian, but it too had problems. Because the Czechs had faced relative stagnation under socialism, they were eager to make economic transitions as quickly as possible. Voucher privatization was the method chosen for most dispersion of state-owned capital\(^3\) and implemented by the 1990 Law on Transfer\(^4\) partially because reformers believed that the government could distribute shares of companies quickly, fairly, and easily by avoiding the direct sale approach (which was perceived as slow and costly as in Hungary) (Dlouhy & Mladek, 1994, p. 157). The program was based on the theory that “breaking the links with the state was the primary hurdle, and that the political window of opportunity had to be seized quickly” (Gray, 1996, p. 183). The program involved the selling of shares of companies for fairly low prices, which the government hoped would limit the problem of low domestic capital while still allowing foreign investment through “equal-access vouchers” (Gray, 1996, p. 190). However, questions remain over whether the Czech privatization was that at all, as firms were considered “privatized” when only a minimum of 20 percent was held in private hands. The rest was divided among the government (20 percent), state-owned banks (40 percent) and the National Property Fund – “NPF” – (up to 20 percent) (Brom, 1994, p. 894). However, the NPF and Konsolidacni Banka provided predominantly monetary support to guard businesses and society by protecting against bankruptcy, which would have resulted in high unemployment (Brom, 1994, pp. 894-895). Therefore, these institutions were not directly involved in the management of the companies, and had more of a peripheral role as financial backers.

Problems with voucher privatization were largely tied to the inability of the Czech government to properly regulate the managers overseeing redistribution of company shares and profits, which lead to inefficiencies and corruption (as in the Hungarian case) (Hare, Revesz, Aven, Oblath, & Hans-Werner, 1992, p. 230). Similarly, people who put little money into their shares (due to the low cost of vouchers and the restrictions on how many shares could be bought) have less of an incentive to demand or encourage aggressive restructuring toward efficiency (Gray, 1996, p. 190). Because of the simultaneous evolution of the political and economic spheres, the Czech Republic lacked a proper legal framework, especially with regards to regulation of businesses after they were sold (Hare, 1992; Dlouhy & Mladek, 1994, p. 160). This has lead to inefficiencies and the dissemination of profits to minority shareholders, rather than the reinvestment of funds into the business to increase efficiency and productivity (Hare, Revesz, Aven, Oblath, & Hans-Werner, 1992, p. 231). More importantly, equal-access voucher privatization “did not generate new investment funds and skills, and it provided little revenue for the government” (Hare, Revesz, Aven, Oblath, & Hans-Werner, 1992, p. 231). Interestingly, while the government believed that purchasers of vouchers would put most money into individual businesses, over 72 percent of buyers put their money into investment funds instead, a few of which accumulated so many shares that the same fund often owned majority stakes in competing companies (Gray, 1996, p. 193).

It is clear that both the Hungarian and Czech privatization methods were hampered by many of the same problems, and the same can be said with their tax systems, especially with regard to their debts. Hungary faced a significant amount of debt, mainly from the failure of industry to adequately predict market fluctuations. The unexpected collapse of COMECON (The Council for Mutual Economic Assistance), which affected all CEE economies, caused many of Hungary’s state-owned enterprises to default on their bank

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\(^3\) \text{state-owned capital}

\(^4\) \text{Law on Transfer}
loans. At the same time speculators expecting price increases in certain sectors stockpiled product without properly accounting for inflation's impact on demand (Adam, 1995, p. 994), and companies could not afford to pay for the pre-ordered items. In 1992, 20 percent of bank debt in both the Czech Republic and Hungary was from such defaulted loans (Campbell, 1996, p. 65). Businesses were not the only affected – so too were banks, many of which faced insolvency if the government didn't pursue bailouts (which in turn increased debt) (Adam, 1995, p. 994; Campbell, 1996, p. 72). Problems were worsened in Hungary by the high social welfare standards, especially with an increasing number of unemployed and pensioners (Adam, 1995, p. 992).

While the Czech Republic did face similar bank bailouts and the problems with a collapsed COMECON, it had relatively fewer problems balancing its budget and thereby incurred little additional debt at the initial political transition (Campbel, 1996, p. 169). Campbell argues that this is a result of "several unique advantages, that helped minimize deficits, such as a good tourist industry, a skilled labor-force, and a relatively modern manufacturing and technological base that helped prevent the enormous declines in output and employment that other countries suffered" (1996, p. 69). In 1994, the unemployment rate in the Czech Republic was a mere 4 percent, eliminating the need for over-spending on welfare programs. Furthermore, consistently low wages in the early 1990s helped to keep profits of enterprises high, allowing taxable profit levels to remain steady (Campbell, 1996. P. 69). However, this does not mean that debt was not incurred, even though in 1990 the external debt in the Czech Republic was below 20 percent (Svejnar, 2002, p. 12). Unemployment was artificially kept high by the Klaus government, which "used the still publicly-owned banking sector to support non-viable firms so as to minimize unemployment" – in effect wasting funds that could have been spent on increasing productivity and efficiency (Bryson, 2000, p. 510). It is clear that adequate tax systems were necessary in both Hungary and the Czech Republic to facilitate debt repayment.

**Taxation Models**

Hungary's implementation of both the value added tax and personal income tax in 1988 (Hare, Revesz, Aven, Oblath, & Hans-Werner, 1992, pp. 233–235) gave an advantage to the country when privatization efforts increased following the collapse of the government. The measures taken in 1988 attempted to foster the growth of enterprises by eliminating heavy taxation on enterprises and instead focusing on citizens (Adam, 1995, p. 990). Reformers in the 1980s recognized that the allowance of legal small-scale firms in the economy provided for the taxation of the black market (the former "second economy"), which would increase overall revenue generation. According to Hare, these pre-cursors to the 1990s gave Hungary the ability to "contemplate both the complete dismantling of the old tax/subsidy system, and large scale privatization, without fearing that government revenues [were] at risk" (1992, p. 235). Such an advantage was especially important in the elimination of "distorting taxes and subsidies" and an attempt at price liberalization before other countries had been able to fully install proper tax systems.

The Czech Republic, on the other hand, had little experience with taxation because of the strict CPE standards (which didn't require a complicated tax system) (Coulter, 1995, p. 1008). The country was forced to implement taxes without having the experience of knowing how successful they would be. Striving to achieve tax equity, "corporate tax rates were unified" and a "broad-based" income tax was implemented (Campbell, 1996, p. 54).
The income tax introduced in 1993, which effectively replaced the wage tax (Coulter, 1995, p. 1011), is progressive and ranges from 15 percent to 40 percent of personal income (Bryson, 2000, p. 514). Direct and indirect taxes were also fairly balanced at their inception, with 54 percent accounting for the indirect portion (Bryson, 2000, p. 514). However, a major problem with the Czech taxation system was related to the proliferation of municipalities following the Velvet Revolution – in 2000 the number was an estimated 6234 (Byrson, 2000, p. 512). While the creation of municipalities was beneficial from a democratic point of view, as “local governments can be more acceptable because its agents are more accessible and are more clearly accountable” (Bryson, 2000, p. 507), the Czech Republic had not adequately thought out the funding of thousands of small governments and the subsequent thousands of public projects. The property tax was the greatest source of funding for such municipalities, but is largely flawed due to the fact that “policy design and implementation remain almost exclusively the domain of the ministers of Finance and Interior” (Bryson, 2000, p. 512), who cannot adequately determine what property tax levels should be for the distinct needs of all municipalities. For instance, property taxes from 1989 to 1993 actually decreased from 1.4 percent of overall tax revenue to only 1.0 percent, even though there was clearly a demand for higher levels of local funding (Coulter, 1995, p. 1011). To circumvent the issue, municipalities have resorted to selling off land given to them by the government during privatization, but these are sources of one-time funding and this method will merely prolong the need for a re-evaluation of the system (Bryson, 2000, p. 514). Some municipalities have simply resorted to going into debt, reallocating the problems to banks and ultimately the national government, which will have to pay off those loans to protect bank failure.

**Exchange Rate and Currency Reform**

The existence in Hungary of a fairly well-functioning tax system at the start of the 1990s (relative to other CEE countries), allowed for much more accessible exchange rate reforms, especially in comparison to the Czech Republic. Devaluation of currency was important to spur exports and reach some kind of stable and controllable monetary policy (Svejnar, 2002, p. 11). Differences in the structures of Czech and Hungarian exchange rate reform are not vast, considering that both chose to utilize a pegged exchange rate as opposed to floating their currencies. This method was preferred by some CEE countries because in theory, it claimed to have an impact on protecting GDP through, according to Sachs, the establishment of monitor-able targets, coordinating price-and wage-setters, and protecting consumers from the fallout of recent high inflation (Sachs, 1996, p. 149). It was the method of policy implementation, as well as different levels of political and economic development, that caused variations in outcomes. Hungary, which again chose a gradualist approach, largely escaped inflationary pressure. This may not only have been caused by a slow devaluation: Hungary received $1.5 billion in foreign investment in 1990, creating a surplus and lowering the inflation rate by increasing demand for the Hungarian florint (Akos, 1992, p. 985). The country’s use of direct central bank loans, rather than servicing the debt through the printing of money (although they did increase the money supply slightly), created non-inflationary funding for the Hungarian debt (986). Unfortunately, this lead to high interest rates which, along with excessively high reserve rations in excess of 55 percent in 1991, deterred businesses from borrowing to invest (986-88). The florint enjoyed fairly positive appreciation, 1.5 percent and 11.5 percent in 1990 and 1991, respectively (Akos,
The Czech devaluation of the koruna was also fairly successful, but the attempt to keep inflation low ultimately caused it to remain undervalued for some time (Stolze, 1997, p. 25). Peter Green surmised that the problems with the koruna that kept it from fully appreciating were related to "the continued poor performance of the Czech economy and the government's apparent inability to cut its trade and current-account deficits" (Green, 1997). The undervaluation may have been a result of the Czech lack of market experience, as it was simultaneously opening its trading borders and changing its currency structure. Hungary, on the other hand, already had familiarity with trading and thus valued its currency more appropriately. Nevertheless, in both the Czech Republic and Hungary in 1994, inflation was below 100 percent (low for transitioning standards), showing that the devaluation of both was fairly successful for macroeconomic stability (Sachs, 1996, p. 149).

The J-curve helps to illustrate some of the effects that currency devaluation had on national GDP in the cases of both the Czech Republic and Hungary. It suggests that when a currency is devalued, imports and exports will remain at relatively the same levels as before (due to their inelasticity), causing the balance of payments problem to get worse as imports are now significantly more expensive. Eventually, the trading partners will realize the lower cost of the country’s products, and exports will rise. In the cases of Hungary and the Czech Republic, once economic transition had progressed for almost a decade, “currency pegs were plagued by a real appreciation of domestic currencies and subsequent increases in foreign currency debt which generated financial instability” (Aghetti, 2003, p. 971). This trend is apparent at the end of the J-curve, which tapers off and may even decline due to lower exports of products abroad because countries can no longer afford the appreciated values (the importing countries’ currencies may not have yet appreciated in response).

**Figure 1: Hypothetical J-Curve**

The dashed line is used to illustrate that the balance of payments initially falls
(becomes more negative) due to currency devaluation, and then rises (becomes more positive) above its original level.

<table>
<thead>
<tr>
<th>Year</th>
<th>Czech R.</th>
<th>Hungary</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>2.1</td>
<td>4.1</td>
</tr>
<tr>
<td>1988</td>
<td>0.6</td>
<td>-0.1</td>
</tr>
<tr>
<td>1989</td>
<td>2</td>
<td>0.7</td>
</tr>
<tr>
<td>1990</td>
<td>4.5</td>
<td>-3.5</td>
</tr>
<tr>
<td>1991</td>
<td>-1.2</td>
<td>-11.9</td>
</tr>
<tr>
<td>1992</td>
<td>-11.5</td>
<td>-3.1</td>
</tr>
<tr>
<td>1993</td>
<td>-3.3</td>
<td>-0.6</td>
</tr>
<tr>
<td>1994</td>
<td>0.6</td>
<td>2.9</td>
</tr>
<tr>
<td>1995</td>
<td>3.2</td>
<td>3.5</td>
</tr>
<tr>
<td>1996</td>
<td>6.4</td>
<td>1.3</td>
</tr>
</tbody>
</table>

**Table 1: Czech and Hungarian Growth Rates**

**Conclusions**

It is clear that these countries took different speed approaches to the transition process, but as Table 1 indicates, both Hungary and the Czech Republic experienced some kind of recessionary pressures with similar statistics. However, it should be noted that these “recessions,” having stemmed from governmental and political change, are very different from those in already stable and industrialized countries (as in the United States, UK, etc). The question ultimately isn’t over why countries must (or generally do) have recession: the J-curve highlights just one major reason why the devaluation of currency ultimately results in lowered GDP (though not necessarily negative growth rates). The question becomes whether or not we should value one method of transition over another. From a strictly theoretical standpoint, it is logical that gradualism would be favored because it allows for the reevaluation of policies before they are fully implemented. However, despite Hungary’s advantages, especially with regard to the pre-establishment of privatization methods and a fairly well-developed tax system (both of which gave market experience to Hungary while the other CEEs remained mired in CPEs), it could not escape its own difficulties. O’Toole and Hare believe that because Hungary’s reform measures weren’t planned simultaneously, it couldn’t adequately reconcile the new, more aggressive reforms necessary after the complete collapse of the Central Planning Office. On the other hand, taxation policy and the inability for privatization methods to produce new skill and finances for the Czech government suggest that “shock therapy” leaves governments playing a dangerous guessing game about what policies it will be able to appropriately coordinate. Furthermore, it is logical that the extensive implementation required by a “big bang” would not only be a source of great confusion, but would also require massive amounts of infrastructural capital. Gradualists are able to implement policy over time as goals are achieved and as funds and personnel become available, but policies made 10 or even 20 years prior to the realization of the “whole picture” may no longer be relevant, ultimately requiring that reforms be themselves reformed.
Evaluating the Hungarian perspective makes it clear that gradualism must be accompanied by a specific political climate at a specific time: even the reform wing of the Communist party in the 1980s couldn’t have predicted that the fall of communism would come so rapidly. Was what happened to Hungary a mixture of gradualism and “big bang,” as in 1990 the reform process needed to be revamped to facilitate a rapidly changing political structure? For the purposes of this analysis, it appears that the most important reforms for the Hungarian economy were made prior to the fall of communism, especially in 1988. It may be unfair to say that any other country could choose to pursue the same approach unless a similarly influential reform wing could effect change prior to a governmental collapse.

The fact that advantages and disadvantages exist for each approach means that, from a strictly economic sense, the “best” transition method cannot be selected because the outcomes rely on subjective rulings. Was it better for the Czech government to compromise efficiency for the sake of job protection via the Konsolidaci Banka in order to transition more rapidly? Or was Hungary wrong in using high reserve ratios to slow growth by deterring investment borrowing? Depending on one’s perspective, both situations are appropriate. In fact, the “best” approach may be neither gradualism nor shock therapy, but something in the middle: a method that takes account of the situations of countries on an individual basis and assesses which policy areas need reform most quickly. Ultimately, I’m not convinced that “speed” should be the focus of any theory on transitioning economies – we should focus more on what policies are best coordinated to avoid macroeconomic instability and only then worry about the rapidity of policy implementation. Although recession may be unavoidable, the most suitable policy reform measures for each economy should produce a plan that executes a transition at the most appropriate speed, which may be neither quick nor slow.

While speed should perhaps not be a major consideration for transition, the outcomes that both countries faced will have important implications for their ability to become fully integrated into the European Union. Having effectively established new currencies in the 1990s gives each of these countries an idea of the logistical enormity that the switch to the Euro will entail. However, changing to the Euro will entail much different challenges. These countries have now established functioning price systems, which were largely absent before the fall of communism. Furthermore, while the banking systems are not as solid as in some other member countries, the EU boasts exceptional examples (e.g. Germany), and appears generally willing to offer advice. A larger issue may lie in the transition to the physical bank notes and coins themselves. Like other countries, giving up the national currency is very difficult in terms of cultural identification, but it may be more so in countries that have just recently reinvigorated and discovered their own sense of national “self”. Countries like Hungary and the Czech Republic had extremely powerful political movements ripe with a new sense of nationalism, and while their governments clearly see the economic benefits of switching to the Euro, giving up something so closely tied to the defeat over communism will not be easy. Regardless of the willingness of CEEs to rapidly switch to the Euro, the European Union must approach these and other Central European countries with caution: forcing changes too quickly could disrupt the foundations upon which these CEE countries are based, not only in economic terms, but also politically. Avoiding recessions tied to a currency change will enable these countries to continue to move toward reaching EU average GDP levels. These countries offer exceptional sites for EU growth and industrial

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development. However, to take advantage of these opportunities, former EU-15 members must attempt to recognize and understand the cultural, political, and economic transitions that CEE countries faced less than two decades ago, and act accordingly. Failing to do so will jeopardize the continued development and transition of CEE countries, and therefore the success of the European Union as a whole.

**End Notes**

1. This topic will be further explored during a discussion on privatization.
2. From this point on, I will refer to Czechoslovakia, under which many reforms were made until 1993, as the Czech Republic, to avoid confusion over statistics that refer only to the Czech Republic.
3. Restitution, public auction, public tender, direct sales, and joint-stock companies were also used, but the voucher program is the form most commonly associated with the Czech Republic by the scholars I have encountered.
4. The official title was the Law on Transfer of State Ownership of Certain Properties to Other Legal or Natural Persons.
5. Table adapted from “GDP Annual Growth Rate” published by the Centro de Economia Internacional (CEI) and available at www.cei.gov.ar/ingles/estadisticas/internacional/Excel/cuadro4_EN.xls.

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