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Postcommunist
Countries

By Prime Minister Václav Klaus



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Interplay of Political and Economic Reform Measures in the Transformation of Postcommunist Countries

By Václav Klaus

The worldwide breakdown of communism at the end of the eighties gives us a unique (we may say an epochal) opportunity to get rid of the irrationalities and injustices of the old, discredited communist regime and to build on its ruins a standard system of political pluralism and democracy and of unconstrained market economy. The country I represent here tonight, the Czech Republic, is in this respect no exception. If there is anything particular about my country, anything I should—with unhidden pride and satisfaction—stress here, it is its relatively very fast progress in both political and economic components of the transformation process. I believe that the Czech Republic has already crossed the Rubicon dividing the old and the new regime. It is an important achievement; we may become the proof that the transformation from communism to a free society can be realized.

The topic of my concern as well as curiosity is to search for the reasons of visible and irrefutable differences in the speed as well as in the nature of the transformation process we observe in various postcommunist countries these days. I will draw on my experience to outline some of the underlying principles of an optimal reform strategy for all countries that may find themselves facing a similar challenge as my country.

Even without a detailed and profound analysis, it is apparent that there are postcommunist countries with very modest success; countries which have fallen into what I call the “reform trap”; countries which have fallen into the vicious circle of incomplete and incorrect reform measures, of increasing inflation and unemployment, of public budget deficits and foreign indebtedness, of accelerating political troubles, of myopic policies which generate even worse outcomes, of chaos and anarchy, etc. We know that such a process usually ends in a deep political-economic crisis and in the further undermining of chances for success.

There are, however, countries which have succeeded in avoiding the fall into the reform trap; countries that were able to initiate a *virtuous circle* based on a mixture of reasonable and therefore effective reform measures. Such a circle brings about positive economic results, political stability, continuation of reforms, etc.

The huge differences we witness are, in my opinion, the result of a specific interplay of political and economic factors in the transformation process. These factors support and complement each other. For me, the central role of such an interplay between economic policies and the political environment is self-evident, but it is often forgotten or at least not fully appreciated.

The systemic transformation is not an exercise in applied economics or in applied political science; it is a process which involves human beings, which affects their day-to-day life, which creates new groups of gainers and losers, which changes the relative political and economic strength and standing of different socio-economic groups and which, therefore, destroys the original political, social, and economic equilibrium. The communist system was characterized by its own, peculiar, relatively stable equilibrium. Whether the new equilibrium and especially the path from one equilibrium to another becomes stable or unstable depends upon the aforementioned interplay.

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What are the lessons I can draw from our experience?

- 1) To be successful, the political leaders must formulate and sell to the citizens of the country a positive vision of a future society.

The first task is its formulation. The vision must be positive (not just a negative one); it must be straightforward (not fuzzy); it must motivate; it must speak to the hearts of the men and women who spent most of their lives in the spiritually empty communist regime. It requires clear words—biblical yes, yes, no, no; it must be stated in an ideal form (which needs “extreme” terms, because the compromises belong to reality, not to images or visions); it must explicitly reject all forms of “third ways,” which are based on incompatible combinations of different worlds.

The communist regime demonstrated, and we have fully understood, that human nature does not want “brave new worlds” (to use Aldous Huxley’s apt term) and that to construct a free and functioning societal system on dreams, on moral imperatives, or on somebody else’s preferences is absolutely impossible. We accept Adam Smith’s teaching. His vision of a free, democratic, and efficient civic society where the citizen, and not an enlightened monarch or an elitist intellectual is the king, is our vision. Because of that, to fulfill this first task—to formulate a vision—is not difficult. It requires just “to know” and to follow proven, conservative principles.

The second task, to sell the vision, is much more complicated. It requires to address the people, to argue, to explain, to defend; it requires permanent campaigning. It requires more than a good communications system, more than sophisticated information technology, more than free and independent mass media. It requires the formation of standard political parties, because without them the politicians have no real power base and there is no mechanism to democratically create politicians, ideologies, and visions. Most postcommunist countries started the transformation without established political parties (and without positive visions as well) and were, therefore, unable to establish a basic, sufficiently strong pro-reform consensus and to start introducing necessary reform steps.

The political and social cohesion of a country cannot be cultivated without a permanent interaction of political parties. This is something the citizens (and politicians) in postcommunist countries were not accustomed to. To overcome their distrust of political parties is not easy, but it must be done as soon as possible.

- 2) The necessary set of reform steps must include both changes of institutions and changes of behavioral and regulatory rules, i.e. changes of the rules of a game.

Without profound institutional changes we cannot establish new agents in the game: citizens, political parties, and parliaments in the political sphere; consumers and suppliers of labor, firms, independent central banks, and “small” and constitutionally constrained governments in the economic sphere (to name the most important ones). Those changes create a totally new institutional (or organizational) structure of the whole society.

Rules are changed by new, spontaneously created habits and customs as well as by new legislation and by subsequent policies. Their substance is on the one hand to deregulate and liberalize, and on the other to define principal constraints and limits of the decision-making spaces of participating agents. That is the only way how to unlock markets, to unleash private initiative, to eliminate excessive state interference, to let the newly formed agents behave in a rational way.

Institutional changes take time. Changes of rules, however, can and must be done very fast. Much of the disagreement about the speed of transformation (shock therapy or gradualism) can be dispelled if a proper distinction is made between the speed of those two conceptually different transformation tasks.

- 3) Such a fundamental change of an entire society cannot be dictated by *a priori*, preplanned, or prearranged procedures. Reform blueprints must be loose, unpretentious, and flexible. The dreams of social engineers of all ideological colors to organize or to mastermind the whole process of a systemic transformation in a rigid way are false, misleading, and dangerous. It must be accepted—as an important transformation theorem—that it is impossible to centrally plan the origin and rise of a free society and of a market economy.

The reformers must accept that this process involves not just them but millions of human beings with their own dreams, preferences, and priorities. The role of politicians in it must be, therefore, rather limited. They can guide and inspire, introduce necessary legislative amendments, implement appropriate policies; they should not, however, try to dictate, command, order. Democracy is indispensable and attempts to ignore it in the name of easier and faster reforms are futile and ineffective.

- 4) The reforms must be bold, courageous, determined, and, therefore, painful, because
- ◆ Economic activities based on subsidized prices, on artificially created (and now non-existent) demands, and on sheltered markets must cease to exist;
 - ◆ Once-and-for-all price jumps after price deregulation are unavoidable;
 - ◆ Drastic devaluation, inevitable to introduce before liberalization of foreign trade, shifts the exchange rate very far below the purchasing power parity;
 - ◆ Income and property disparities grow to an unprecedented level, etc.

These changes and their impacts must be preannounced, preexplained, vigorously defended, and “survived.” The costs the people have to bear must be widely shared, otherwise the fragile political support is lost. Telling the truth, not promising things which cannot be realized, and guarding credibility of reform programs and of politicians who realize them are absolute imperatives.

Once-and-for-all-changes constitute necessary byproducts of any kind of a systemic transformation; galloping inflations or hyperinflations, repeated devaluations, prolonged GDP declines, state budget deficits, and growing foreign indebtedness are, however, avoidable by a positive interplay of political and economic reforms and by introduction and implementation of rational macroeconomic policies, based on conservative foundations. Monetarism, not Keynesianism; fixed-rules, not fine-tuning; balanced budget, not fiscal activism; self-reliance, not dependence on foreign mercenaries: these are the inspiring words for all of us who want to accomplish the historic transformation, for all of us who want to create a free, democratic, and efficient society.

Questions and Answers

Q: What is most important for the United States to do to help, and what is the least important? What should we not do?

A: I can comment on the U.S. policy as an independent scholar, but as the prime minister of a country in Central Europe it is rather difficult. You know what we are trying to do. We are moving from one side, really, to another, and we will find the point where we stay. We don't mastermind that moment in the whole spectrum of political and social and economic and ideological sense, but definitely the move is from one side to another. The citizens of our country are frustrated to see that the leading country of democracy and free market is probably moving in the opposite direction. And I can tell you that the opposition—the political parties—try to block exactly what I have been discussing here today. They take tremendous pleasure in repeating some phrases, some words which are fashionable in this country these days. It is a very complicated domestic fight for us. I definitely don't want to suggest anything to the politicians, or to the voters, of the United States of America. They are free to decide, free to choose. But they have chosen. They have made their choice. I think that it is the best decision for most people in this country.

Our move was to deregulate and fully liberalize foreign trade. So for us to hear about attempts to introduce trade policy causes difficulties. The problem is that I have to face criticism from various lobbying groups in my country to introduce such market-friendly trade policies as in the United States of America. Maybe a rich country can afford to pay some unsuccessful firms to be able to export. Our country is not rich enough to do that.

It helps us to avoid such a policy, because we can very easily say to those lobbying groups that we are sorry, we don't have money for that, and we regard so highly a balanced budget that we don't want to introduce a budget deficit. So, in this respect it helps.

We try to avoid central planning, which means the masterminding of economic activity by government bureaucrats—nobody else. We hear in America words about industrial policy, which is something very similar to what we used to call central planning in the past. So again, those are troubles. I don't want to analyze how positive such policies are for the country in which I have the privilege to be today. I am saying that such rhetoric complicates my arguments at home.

Q: Is it not terribly important that each nation does this for itself, not reaching outside to the World Bank, to the IMF, or the institutions of the world?

A: I used the privilege of speaking in Britain to comment on the foreign involvement, or the foreign dimension, of the transformation process. And as you know, our country rejected aid, help, assistance. It is not just that we are proud that we can do it ourselves, it is because we are deeply convinced that such aid, assistance, help is wrong and counterproductive. We are very much against one-way transfers because they are not taken seriously, neither by the donors nor the recipients. They are misused, misdirected. They simply disappear. They are very often counterproductive. They prolong the moment when the necessary domestic changes have to be implemented. So, we are in favor, as we are economists, of the idea of exchange. Exchange means the bi-lateral involvement of two parties. The exchange must be advantageous, beneficial to both sides, otherwise it is absolutely meaningless. We want involvement which is beneficial to the U.S. investors in my country, to the U.S. businessman buying goods, selling goods in the Czech Republic.

I really think it has a very deep meaning, not just for our country, but for all of the postcommunist countries. All of the debates about how to help Yeltsin or not to help, which way and which form to help him, help him against whom or help him for what, and so on and so on—those are the real issues which are implicitly hidden in that paradigm. So, I use that argument for discussing the involve-

ment of international financial institutions in the postcommunist world. They are not giving us anything for free.

What I tried to say today is that we need them to function in a different way. What I said is that we need them to be there, but to take risks, not to be there in the absolutely sterile environment where governments of the countries involved are permanently asked to grant government guarantees for the work for the development bank loan to somebody in the Czech Republic. That is absolute nonsense. If you are asked to guarantee something, it means that the World Bank did their homework poorly. With all of their abilities, capabilities, experience, they should be able to say whether or not a project is viable. Why then should they ask the government for state guarantees? I know that at the institution there is a tremendous risk-aversion. It is the constant of human behavior. But those institutions have in this respect a very special position: they are more risk averse than the rest of us, so they should do something more risky. Otherwise, it is not a help.

Q: You are one of the very few economists who have proven to be good politicians. What is the secret?

A: It is hard work. And it needs permanent campaigning. I had here some six speeches today, and several yesterday in New York City, going directly from the airport to the Council on Foreign Relations, and so on. This is the secret. We are doing the same at home as well. Before coming here, on Sunday night I had one public rally in Prague. On Monday evening there was a public rally of some three thousand people in another city, with two hours of questions and answers in which I was explaining, defending, and arguing. And this is the secret. I may know better than some other politicians in Central and Eastern Europe what is discussed in sophisticated American economic journals, but the secret is hard work and permanent campaigning.

Q: How close are you to removing the remaining price controls on energy?

A: I don't like such questions. You know why? It is like a disabled man who lost his leg when he was three years old. Then the secrets of modern medicine succeeded in creating his leg, and he is absolutely happy that he is beginning to walk. And your question is, "When do you plan to participate in the New York Marathon?" I can name many products in this country where there are various forms of government intervention, and we can compete on those.