

## Transition From Communism: A Decade After

On April 21, 1999, Pioneer Institute held the second annual [Lovett C. Peters Lecture in Public Policy](#). "Transition from Communism: A Decade After," was delivered by **Václav Klaus**, former Prime Minister of the Czech Republic and current President of the Chamber of Deputies of the Czech Parliament. As the first non-Communist finance minister in more than 40 years, Václav Klaus led the reforms that put the Czech Republic on the road to a free market economy. His economic program included the immediate lifting of price controls, currency convertibility and devaluation, and tight monetary policies. Massive privatization was also an earmark of the Czech program. Professor Klaus became Prime Minister in June of 1992, a position he held until November of 1997. The author of 19 books, Professor Klaus is a member of the Mont Pelerin Society and the recipient of 14 honorary doctoral degrees in seven countries.

In the following pages, Pioneer Institute has reproduced an edited transcript of his remarks.

I must first say that for someone who spent most of his life in a Communist era, the word "Pioneer" has just one meaning: The pioneers were the members of the Communist Youth Organization, who wore red scarves and marched in the first of May parade. They were the future builders of Communism. So I had trouble when we began corresponding with the representatives of the Pioneer Institute. It is an irony of history that the Pioneer Institute is now fighting for completely different ideas than the young pioneers of twenty or thirty years ago in my country.

The title of my talk is "Transition from Communism: A Decade After." I have expressed my views about transition and described my experience of it in many speeches and articles. And it is probably too early to add anything to my original "Ten Commandments of Transition."<sup>1</sup> So today I will make only a few short remarks.

It seems to me it would not be very productive to describe the events that happened in the past. I will only recall when the Czech students organized the demonstration in Prague. I returned at 10 o'clock one evening from a trip not knowing what had happened. My son met me in front of our house. He was returning totally shocked and scared from the demonstration. He said, "Father, we children have done our task and it is now the task of the fathers to continue."

It is the debate, over where to go and how to get there, that is still relevant. Where to go was not so easy ten years ago. Yes, nobody wanted Communism so it was very easy to eliminate all the Communist institutions, but very soon the conflict of visions started. When you have to turn a negative vision into a positive one, you immediately discover that you live in a very complicated pluralistic society, with many competing ideas. I think we succeeded. We, the group around me and my political party, had a chance to influence the first few years. Our goal was summed up in the well-known phrase, "market economy without adjectives." This was very important because I am absolutely sure that any additional objective in Europe, such as the very popular "social market economy," simply kills the idea of a free society and a market economy.

I would like to put the problem of transition into a broader perspective and discuss selected aspects of the process. We are rapidly approaching the end of this century and the beginning of a new one. We can say, at least looking at the world from central Europe, that the 20th century brought us two wars. It brought us two occupations of our territories. And it brought us two very dangerous ideologies: Fascism and Communism. We were liberated three times. We were first liberated in 1918 from the Austro-Hungarian monarchy. We were liberated in 1945 from the German occupation. And 10 years ago, in 1989, we were liberated from Communism. Looking back over the century we can say that only three decades, the 20s, the 30s, and the 90s, have been periods of freedom and liberty, which is approximately one-third of the century. Knowing the circumstances, it is very difficult to say whether it is a good result or a bad one, especially as compared to other eras in our own history.

I agree with Isaiah Berlin who once said that the horrors in the 20th century were not caused by ordinary negative human sentiments, but by ideas." This is, at least for me, a very important starting point. I am

really more afraid of some ideas than of nasty people, of wicked or evil persons, of villains. Even if Communism is over, I am definitely not alone in seeing, hearing and feeling ideas I consider dangerous. We should not, therefore, interpret the end of Communism as a final and comfortable victory. We should be "on guard." Contrary to the "end of history" or "end of ideology" schools, the end of Communism does not mean the end of the great ideological debate that has dominated the century. It began one, or it should have. The debate should have taken place much earlier and should have been deeper and subtler, but Communism distracted us from it.

Yesterday I had a chance to give a speech to the Kennedy School at Harvard University. One of the gurus on the other side of the barricade, the famous Kenneth Galbraith, came. After listening to me, he immediately said, "Well, it's a mistake to talk about ideologies. You should be pragmatic. We should do the right things."

I am very sensitive, after living in a Communist area, about the term "we." Who is "we"? I tried to tell him that as long as there is a human society people will have ideas. People will have dreams. People will have visions. And people will have ideologies. There is nothing wrong with that. I told him that you can eliminate ideologies only one way, by introducing a totalitarian regime, which I know from my own experience. The "Third Way" ideas are here again. At the World Economic Forum in January 1990, I was asked about the Third Way, and I responded that the Third Way is the fastest way to the Third World. We should not fall into the same trap as in the past. At the same time there are some new traps and they look different, especially environmentalism and communitarianism. Both of them represent a danger to freedom, liberty, and democracy. Both of them imply that someone's ideas are better than the ideas of the rest of us, and that someone knows what is good for me and for you.

The decade of the 1990s started with many hopes connected with the fact that Communism had collapsed. It was not defeated, it just sort of melted down. The long-awaited event created enormous expectations and as a result something happened that I call the "e-r gap," the expectation-reality gap.<sup>2</sup> In spite of many undeniable achievements in most transition countries during the decade, the e-r gap has been growing, not getting smaller, not closing, which has led to a serious loss of confidence in both transformation results and transformation strategies. Dramatic controversy about both of them continues and will be with us for some time to come.

I am sorry to say that the Western intellectual contribution to this controversy has not been very helpful. We learned a lot from ideas and concepts belonging to mainstream economics and mainstream social sciences. But there has been almost no serious academic research concerning transition from Communism to a free society, and the quality of available texts is not above the former sovietologist literature, which we, living in Communism, did not find very helpful either. It is unfortunate that the absence of an academic analysis is made up for by a non-academic one. The debate about transition economies and emerging markets (and also developing countries) is dominated by a very powerful rent-seeking group. This group of advisors and consultants, of investment bankers, of powerful auditors, and especially of bureaucrats of international financial organizations have a vested interest in prolonging transition as much as possible, and in not letting transition countries do it domestically, which means without them. My refusal to surrender unconditionally to their views made me many enemies in this privileged group. At a World Bank meeting, I was pushed to accept what was called a technical assistance loan. I said, "No, I am ready potentially to accept a loan for building something but not a technical assistance loan." I made another statement, which Milton Friedman has called Klaus's Law. I said, again quite innocently, "I am not ready to pay hard money for soft advice."

To paraphrase the well-known saying attributed to Milton Friedman, there is no such thing as a free reform. Any change is costly, in any society. Any change means reallocations, disruptions, dramatic changes. The change of the whole political, social, and economic system is very costly. This was not taken for granted 10 years ago. Everyone expected it would be easy to do. Just to give you an example and my country was more successful than most similar countries the transformation costs consist of one-third of our industrial output, that is a lot, one-quarter of our agricultural output, and one-fifth of our GDP. It is a visible and very tangible loss. There was a visible increase in inequality of income and wealth. There was a loss of past behavior patterns, which somehow make life possible. You have to have some patterns of behavior; you cannot try every morning to behave in a new and innovative way.

The costs have to be paid by citizens of the transforming countries themselves. There is nobody else in the world who would do it. And the contribution of the rest of the world, if at all, is marginal, if not a

negative one. When I said something similar at the Kennedy School yesterday they were very unhappy. They believe that the contribution of aid, help, assistance is enormous. I simply do not believe it is true.

The reforms start with liberalization, deregulation, and prioritization. Liberalization and deregulation measures can be implemented quite rapidly. Price liberalization is an easy task you can have a meeting of the government at nine o'clock and decide that tomorrow morning at nine o'clock, prices will be free. That is very simple; it just needs some courage and political support. Nevertheless, such reforms create only relatively weak and shallow markets and very imperfect market infrastructure or market institutions. You cannot dictate the creation of markets by government decree, by legislation, by regulation. The market simply must evolve. The same is true of the market's accompanying infrastructure and institutions.

We have been heavily criticized for weak markets and imperfect institutions. But there was no other way to proceed. It was not possible to stop the evolution of a tremendous social process with its own internal dynamics. We simply had to live in an imperfect world. This was not fully accepted many famous economists came and said, "Well, the markets are not very perfect. Wall Street is still better than the stock exchange in Prague."

I must say that maybe we underestimated some potentially positive contributions of the state. Why? Distrust of the state was much stronger in our part of the world than in yours. We have been victims of government failure on a much larger scale. We believed that market failure is less dangerous than the failure of the government. We did not trust the government to introduce a sophisticated regulation. This is one of the problems of the current period and of the overall reform strategy in my country and elsewhere. Many reforms failed or had very high costs because of their partiality and because individual reform measures have different time dimensions. This is an unavoidable fact of life, which should not be superficially criticized.

We understood very early the fallacy of the artificially introduced dilemma "shock therapy vs. gradualism." Fundamental systemic change is a sequence of many distinct choices over time on separate components of an overall reform plan. It is not a single decision. To interpret it as shock therapy or gradualism is simply nonsense. The transformation takes a whole historic period and is not an exercise in applied economics. Systemic change is not done in a laboratory or in a vacuum. It is done in a very complicated political process, in an open democratic and pluralistic society. There is no masterminding of it.

I was at MIT today where sequencing is always a very popular debate, theoretically interesting but practically absolutely irrelevant. I know that theoretically it is very nice to create the plan, but social life is not a project. Sometimes you have an idea, you live in a coalition government, your partners do not accept it, and you send the legislation, the bill, the draft, into the Parliament. Then they change it and so on. It is not possible to say you first do thing number one, then thing number two, and on to 57 and 389. Nothing like that works. I agree with the New Zealander, Roger Douglas. He used to be Minister of Finance and was responsible for the dramatic transition and liberalization of New Zealand's economy and society. He made a very good point about sequencing. He said, "Whenever there is a chance to make any step, do it."

We should be aware of the fact that a country, in the moment of transition, does not make marginal changes. It makes substantial changes. This is consistently what I have to explain here in the United States. At Pioneer yesterday, we discussed a big issue of deregulation here in Massachusetts, a detail in the law that makes building more expensive only policemen can direct traffic around projects. My former colleague, now the Council General of the Czech Republic for New York and this area, came yesterday and during lunch he said, "Well, it's interesting the Americans can be so serious about such details." And I said, "It's okay when you have the luxury to talk about details." But it is necessary to know that we were making fundamental changes in the Czech Republic, not marginal changes.

For you in the United States to change the health care financial system is a big change. We made 100 such changes in the last decade. Ten years ago in Prague and the Czech Republic there was not one private grocery store. There was not one private cafe. There was not one private hairdresser. We now have the task of privatizing the railways or not, of privatizing the post office or not; this means that the fundamental changes have already been made.

Understanding the difference between marginal and substantial changes is absolutely crucial. There has not been a long gradual spontaneous evolution of institutions, rules, or networks of relationships based on

the enormous variety of human interests, hopes, dreams, and ambitions as in your country. Because of that, we still live in a preempted system, which does not have the friendly softening mechanisms of intermediation between the invisible hands of the market and the very visible hands of the government. Such an intermediated structure cannot be imposed on society from above. It has to evolve.

In our society, of course, pressure groups often succeed in using legislation for gaining powers and privileges at the expense of both individual citizens and the state, and for shifting society from traditional liberal democracy to "neocorporativism." It has an important connection to the currently very fashionable idea of communitarianism. I must say that communitarianism is less dangerous in a major, sufficiently diversified society, but it may very easily refeudalize society in an immature, and in this respect shallow, society.<sup>3</sup>

A further problem is connected with the unavoidable fragility and vulnerability of transition economies, especially when they are confronted with the growing and merciless requirements of a globalized environment. We quite innocently opened ourselves to the rest of the world and now we see trouble. The transition economies have very particular characteristics, particular propensities, to use the economic phrase, a propensity, especially, to higher inflation and to current account deficits, which are not compatible with fixed and stable exchange rates.<sup>4</sup> Transition economies have, at the same time, investment-savings imbalances. And therefore they need foreign capital to insure some sort of macroeconomic equilibrium.

Foreign capital wants fixed exchange rates and very easy outflow possibilities. All of that does not exist simultaneously and will probably never exist. My experience tells me that the reconciliation of all these variables, economically speaking, cannot be masterminded beforehand. It must be enforced on the economy as a result of financial, economic, monetary instability or crisis, as it happened in many emerging economies and in many transition economies. Of course, then the political support disappears. Transition is a very complicated mixture of political, social, economic, and cultural aspects. And it is a mixture of intended and unintended moves and events.

Therefore, I want to warn against the underestimation of transition complexities. I want to warn against various misinterpretations and false labels, which make very easy headlines the absence of the rule of law, crony capitalism, mafia capitalism, and all the labels you see. But I would definitely defend other countries, not just mine, because all of them struggle. They muddle through a difficult, complicated process. I want to present transition as a painful process, connected with dreams, hopes, ambitions, prejudices, fears, and of course errors, the errors of human beings. It cannot be done differently.

I will conclude only by recalling a discussion I had last night about Ludwig von Mises and Human Action, his famous book. It was von Mises that rightly pointed out that the world is run by human action and not human design. And we should never forget it.

## ENDNOTES

1. Address delivered to the plenary meeting of the Group of Thirty, Vienna, April 1993. Published in *Renaissance: The Rebirth of Liberty in the Heart of Europe*, CATO Institute, 1997. [BACK](#)
2. See 1997 Annual Hayek Memorial Lecture, IEA, London, June 17, 1997. [BACK](#)
3. See "Society and the Crisis of Liberalism," speech to the Alpbach Forum 1998 Seminar, August 22, 1998. Published in *Policy*, No. 4, Vol. 14, 1998, Sydney. [BACK](#)
4. See "Emerging Markets and Their Current Problems: The Czech Perspective," speech delivered at the Delhi School of Economics, New Delhi, March 11, 1999. [BACK](#)

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