

# The relative role of domestic vs. external factors in the integration of former communist lands into the world economy\*

(practical notes of an insider)

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## INTRODUCTION

Even if it is impossible to add anything unknown, new or extraordinarily important to the growing literature in this field, let me use my special perspective of an active insider for making several comments. Not underestimating the first positive and, without doubt, promising results and achievements, former communist countries face tremendous problems and still have a long way to go. Nobody knows it - or perhaps should know it - better than this distinguished audience. The members of the Mont Pélerin Society have been - for four and half decades - trying to warn the citizens in the free world and especially one special group - the ambitious, self-assured, creative and often irresponsible intellectuals - against the dangers of communism, interventionism and collectivism and to turn their attention to the vulnerability of democratic institutions, of the market economy and, therefore, of the whole free world.

My starting point is my certainty that democracy, freedom and market economy cannot be implanted into an unprepared and uncooperative soil from outside, by decree, by lecturing or by giving good advice. It is not sufficient to translate one or another of the democratic constitutions and to implement it by command from above, it is not sufficient to send groups of well-intentioned advisors, to write off some debts or to grant modest financial injection. The establishment of a free and democratic society and of a functioning market economy cannot be realized by a single act based on **human design**. Our conservative philosophy helps to tell us that such a systemic transformation is a prolonged process of **human action** with millions of actors playing their own independent and sometimes conflicting roles. It is a multi-dimensional process (because the society cannot be compartmentalized), a process of a constructive evolution of thousands of new institutions and of different modes of human conduct accompanying them. It is a process of mutually reinforcing or mutually weakening efforts, trials and errors of men and women with their own interests, dreams, prejudices and capabilities.

Because of that, the systemic transformation of a communist country takes a non-negligible time period. If the transforming country has a clear, strong and convincing vision of where to go, pragmatic, flexible and understandable reform strategy (how to get there), high degree of political and social cohesion and bold and inspiring politicians the results do come and the whole transformation can be successful. If such preconditions are not there - and in most former communist countries they are not - there is no way of avoiding the reform trap and a vicious circle of small, more or less accidental, partial, and overcautious reform measures which result in an economic collapse and a total disintegration of the whole society.

The task of responsible politicians is not to allow it to happen. We have to keep moving ahead, not to stop, we have to be honest and open, not to create wrong expectations, we have to be able to demonstrate visible

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achievements, not to show hesitation, lack of courage, inability to guide or to make decisions.

#### (i) The Role of External Factors

Before starting to discuss in more detail the importance of domestic reform measures, I will make a few comments on the external side of the transformation process. My experience tells me that **reform begins and ends at home** and that the role of external factors is relatively small. It is definitely smaller than is usually expected. The problem is that stressing external factors more than is adequate turns attention to wrong arguments and encourages the widely spread belief that some suspicious outside forces control the transformation process, which is simply wrong and, in addition to it, politically dangerous. I hesitate to discuss the role of external factors here, where everybody knows the work of Peter Bauer and his almost canonical arguments about the impact of external aid on the development process (the most recent summary "Western Subsidies and Eastern Reform", in CATO Journal, vol. 11, No. 3, Winter 1992 is in this respect highly relevant), but this issue should not be underestimated. There is no doubt that there are external factors with a positive impact:

- the rapidly growing **flow of visitors** (both tourists and businessmen) from abroad, who bring into the country market-oriented attitudes, habits and experience;
- the **international trade** with goods and services which undermine the long prevailing atmosphere of semiautarchic centrally planned economies and of highly sheltered markets, which destroys the economic and political power of domestic monopolies and which brings into the transforming country real competition and previously non-available world standards;
- **foreign real investments** provided the country is in a situation where property rights are already clearly defined and reasonably protected;
- **macroeconomic stand-by arrangements** (stabilization funds), which are absolutely necessary for facilitating the moments of price deregulation, of foreign trade liberalization and of convertibility introduction in countries with zero hard currency reserves and with high hard currency debts.

There are, however, other external factors which are usually considered positive but which, in my understanding, have an a priori unclear sign of impact. Into this group belong:

- **technical assistance and consulting.** This form of "aid" is offered either by extremely expensive private firms with insufficient understanding of the transformation problems and of the countries in question or by foreign governments or international institutions which very often employ people with a dirigistic or openly socialist outlook who are practically opposed to the transformation task. The marginal product of such activities may even be negative;
- **financial assistance** from international lending institutions brings about similar problems because they have a deeply rooted tendency to favour government projects and not the creation of a strong private sector. The results are, therefore, dubious.

We are, however, confronted with factors which have fully negative consequences upon the transformation process:

- existing or newly-created **trade barriers** either in individual countries or in regional blocks (recent restrictions on Czechoslovak steel exports to the EC or on cement exports to Austria have to be mentioned);
- the procedures, charters, instructions and obligations connected with membership in **international organizations** with an almost **forced participation**. They were created in a different world and time and they bring back approaches we try to get rid of. In addition, they absorb, in our situation, an extremely scarce resource - experienced staff in the public service, business and academy;
- promises of **debt reduction** or of debt cancellation, which suggest dangerous rules of the game. A possibility not to meet one's obligations was part of the old communist regime;
- **statist or collectivistic ideologies and procedures** imported from abroad may not be totally damaging in fully-developed democracies and market economies but are more than harmful in newly born democracies and fragile markets.

On the whole, the contribution of external factors in the transformation process is, in my opinion, very limited at best. The West should, therefore, not regard them as of vital importance. The only way to create the conditions necessary for free human activity as well as for economic advance and growth in a post-communist world is to move toward a market economy and private property as fast as possible.

#### (ii) Domestic Factors

My active personal involvement in the whole process, available theoretical understanding of its subtle-

ties, peculiarities and pitfalls, my country's experience and my interpretation of events in other post-communist countries suggest factors which mostly contribute to the apparent lack of success in the transformation processes all over the world. Let's briefly discuss some of them.

- a) Many countries (or better to say, reform politicians in many countries) start the whole process with **wrong visions**. Looking at explicit or implicit visions, one is confronted with non-negligible residuals of socialist (or collectivist or interventionist) doctrines, dogmas and ideas on the minds of both political leaders and of common citizens in transforming countries. These deeplyrooted misconceptions and prejudices are - especially for outsiders - hidden behind the colourful facade of permanently repeated words like reform, liberalization, privatization, etc. and can be revealed only after a more careful study. The third-way thinking still represents - with the exception of one, two countries - a real danger and should not be underestimated.
- b) The visions of the post- transformation world are supplemented with a strong belief in the necessity of **constructivism and government master-minding** during the transformation process itself. The basic Hayekian dilemma of human design vs. human action becomes more and more understood and accepted but almost everybody (especially the opposition) wants detailed reform blueprints (as regards both substance and timing) and a perfect cost-benefit analysis of the whole systemic transformation. Such blueprints and calculations are on the one hand not possible to make and on the other not necessary to make. But our unwillingness as well as inability to make them is a source of permanent criticism. To accept such a criticism or not to be able to resist it significantly blocks the reform and ties up the reformers' hands.
- c) The unavoidable tension arises because only some reform measures can be done overnight, whereas most of them take a much longer time. The evolution of new political and economic institutions - political parties and constitutions, private firms, banks, financial intermediaries and necessary legislative framework - is much slower than the collapse of central planning or than the price of foreign trade liberalization. The outcomes of political and economic processes are hence, far from optimal.

Political life and parliamentary pluralism need strong political parties and an oligopolistic (but not monopolistic) structure of the political "market". Post-communist countries have at this stage too many, and, therefore, weak political groupings (it is sometimes difficult to call them parties) and the resulting atomistic structure of this market makes it difficult to put together a necessary political consensus. In the economy it is otherwise. We need "perfect" competition with many participating economic agents but we inherited administratively-formed monopolies and oligopolies. Both markets are weak and, therefore, less efficient than expected.

- d) Speaking about expectations, one has to mention the well-known phenomenon of unfulfilled expectations. Relatively inefficient political and economic processes (in the first stages of the reform) and an aggressive social demagoguery organized by left-wing political parties create a feeling of the lack of success and undermine the public support for the continuation of the reform process.

Without a permanent patient explanatory crusade on the side of reform politicians, the public support can be lost - as happened in some countries already - and democratic elections can give decision-making power to less reform minded politicians in a better case or to reform opposing politicians in a worse case.

- e) Sudden opening of freedom together with a sort of ideological vacuum creates opportunities for pursuing false ideas, values, and priorities. The most dangerous are, undoubtedly, nationalistic ambitions of some political leaders (and of their followers) who push aside basic democratic and market economy values and turn away popular attention from crucial political and economic reform measures. I am sorry to say that even in my own country the separatist tendencies are gaining momentum and the country will be di-vided. The national emancipation - as we dis-covered - is difficult or impossible to realize in a federation and the splitting of countries is an unavoidable process, whether we like it or not. (And I do not like it). Newly created, much smaller countries can, probably, survive but precious time is lost, and the reform trap is getting closer and closer. Because of nationalistic disputes the reform is practically put aside.
- f) In addition to all of that there are the real transformation problems. First, we have the **sequencing issues**. Sophisticated literature appears and the sequencing becomes a topic of scientific disputes. But in practice we are not able to fully control sequencing of reform measures, and we

have to restrict our intervention to a few basic principles:

- we have to permanently pursue macroeconomic restriction to stop inflation;
- we have to start with deregulation, liberalization, convertibility and privatization at the very early reform stage;
- we have to immediately introduce any feasible reform measure with firm belief that others will follow (not the other way round). To wait for the whole set of perfectly coordinated measure is impossible (similar point was recently made by Roger Douglas with his New Zealand experience).

Second, you have to decide where, when, and **how much to Intervene**. It is trivial to say nowhere, never and as little as possible. The issue is real, and we have to face it with no a priori rules but with a pragmatic approach. Because of incredible irrationality of economic policy in the past some, microeconomic - therefore, non-systemic - interventions must be realized, but they must be exceptions only.

## CONCLUSIÓN

The faster we transform our societies and economies the faster we will be integrated into the world economy. We have to cross the Rubicon between the two systems and at that point the process starts to have its own dynamics which may be stopped by huge mistakes only. Therefore, no sophisticated master-minding is necessary.

To summarize, to be successful we need:

- credibility,
- speed,
- scope,

or to put it differently, we need maximum transparency of reform policy (with special attention given to pre-announcement of crucial measures), we have to go rapidly because gradualism is not feasible and we need a really comprehensive reform - based on micro and macro steps, on the development of institutional set up and on rational monetary and fiscal policies.