

Yegor Gaidar and the Economics of Transformation*

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It was a great pleasure and honour for me when your rector, prof. Djankov, asked me to address this academic audience on the occasion of the New Economic School's commencement ceremony. In the first two decades of its existence, your school has gained a very good reputation both at home and abroad and I am really glad to be here. And I am particularly glad to be here now when Russia is so disputed and – in my understanding – not fully correctly interpreted in the rest of the world.

The commencement speech is connected with the name of Yegor Gaidar who was – certainly not only in my eyes – one of the most distinguished Russian economists of the modern era and one of the most democratic and liberal politicians in post-communist Russia. I had a chance to meet him several times and was always impressed by his friendship and good-heartedness, by his sincerity, as well as by his sharp analytical thinking. There are two moments which keep returning most often to my mind:

- One was our meeting in Prague, in my office in the Czechoslovak Ministry of Finance, at the beginning of the 1990s. He wanted to hear my story, the story of my engagement in politics. I explained him that originally, in the moment of the fall of communism, I did not have higher ambitions than to be recognized as an economic expert. I was fired from the Czechoslovak Academy of Sciences after the 1968 invasion into Czechoslovakia by Warsaw Pact armies and for long two decades lost my academic position.

Nevertheless, after becoming the first non-communist Minister of Finance, I understood very rapidly that in a democratic society this role has no meaning without a strong political mandate or – at least – a sufficient political support. When such a support didn't exist, I decided to form my own political party. With this party, I succeeded in winning the parliamentary elections and became Prime Minister. I remember that Yegor Gaidar attentively listened. It seemed to me that he conceptually agreed but hesitated. He was not sure the same story could work in Russia;

- I will also never forget his very clever answer to a hostile and aggressive question at a conference in Warsaw organized to celebrate ten years after the fall of the Berlin Wall. He was attacked, not just academically criticized, for the imperfections and inconsistencies of Russian reforms. He did not try to make excuses and did not start repeating his just finished, quite sophisticated lecture devoted to the same issue. He said: "I was only Prime Minister of Russia, not Czar of Russia". This was a crucial point for those who wanted to understand. All true reformers know the many constraints they had to face and are aware of the very limited power they have – I stress – in a non-totalitarian society.

We all miss him. He was a very good economist belonging to the older – but good and unjustly abandoned – tradition of political economy. He learned it in the communist era and became an example of the fact which the now dominant, oversimplified and over-trivialized interpretation of the communist era makes almost impossible to comprehend. **He proved that it was possible to study economic science even then and that there is no excuse for those who did not do it and keep saying that it was not possible.**

Some of us, and Yegor Gaidar belonged to that group, were convinced that we were obliged to use even the tragic years of communism in the best possible and productive way.

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That we should try to maximize our own personal, of course only implicit utility function given the existing non-trivial constraints – the external ones (based on the oppressivity of communist regime) and the internal ones (formed by our own beliefs, convictions, morals, and preferences).

I tried to discuss these issues in a book I wrote five years ago, on the occasion of the 20th anniversary of the fall of communism. It was published in Czech with the title “**Kde začíná zítřek**” (**Where Tomorrow Starts**). It exists also in Russian language “**Где начинается будущее**”¹. I feel very strongly that we still owe the people in our countries and especially the future generations an appropriate, non-trivialized description and a truly scientific analysis of the oppressiveness, irrationality and inefficiency of the communist regime. We should take it as our task for the future. **Without it, a proper understanding of the post-communist era is impossible.**

The years of communism were lost years, but not useless or empty years. Some of us tried to build our own “human capital” – a term I hope you were taught during your studies here in the way it was innovatively used by my good friend, recently deceased prof. Gary Becker, whom we all miss very much. Yegor Gaidar built his own human capital and due to it he happened to be prepared to play the role he was chosen to play in Russia in the early 1990s.

His life is also a proof of the importance of economic theory, of its practicability, of its productive applicability in the real world. I take this fact as a positive and promising message for those who study or just completed studying economics. I firmly hope there are future Yegor Gaidars sitting somewhere in this audience.

Let me use this very unique opportunity to discuss some of Yegor Gaidar’s topics. My comments can be divided into three groupings:

1. The economists, turned politicians in the moment of the fall of communism in Central and East European countries, knew that they had to attempt changing the whole economic, political and social system. They wanted to accomplish a **fundamental and total systemic change**. Some of them understood quite well that partial, piecemeal reforms will not do. Some of them realized that they had to put together “**a critical mass**” of steps, measures, changes at one moment – for two main reasons:

- knowing that the changes will not be painless and costless (however necessary and inevitable they were), the reformers had to convince the people that they were serious, that their ambition was to make a substantial change, that they did not maximize the number of years in office by making only superficial, easy changes;

- they wanted to achieve a real change – against all the attempts of status quo defenders and against powerful inertia of institutions and of people’s behaviour.

Not all of us succeeded in this respect and in spite of my very limited knowledge of the Russian reality I dare say that Yegor Gaidar made a fundamental breakthrough. There are several other names of his colleagues who deserve to be mentioned, but his is the most important one.

¹ Художественная литература, Moskva, 2011.

2. The second precondition to succeed in economic transformation was the ability **to put all the necessary ingredients together**, without omitting – for the lack of knowledge and competence or political power – some of them. I want to be well-understood. I don't speak about perfection, about a 5 000 pages long, ex-ante prepared blueprint of comprehensive reforms, implemented – eventually – after years of preparation (facing the growing impatience of suddenly free people). I also don't speak about the would-be merciful, friendly to everyone, Joseph Stiglitz's style gradualism, which is a phony and deceitful nickname for doing nothing. **I speak about a practical, meaningful, flexible, adaptable, realistic project.**

It is difficult to put together all the ingredients **in theory** because we deal with a multidimensional system and with real people (not with pawns in a chess game) and it is much more difficult to do it **in reality**. Before the fall of communism, people like me and Yegor Gaidar studied all kinds of theories about the so called **“optimal sequencing of reform measures”**. My experience tells me that anything like optimal sequencing is possible only in textbooks, not in reality. Detailed masterminding and fine-tuning of systemic changes is impossible. Some elementary rules, however, exist and should be followed. I would include among them the following ones:

- I already mentioned the importance of a “critical mass” of reform measures to be done at the very beginning;
- it is not less necessary to achieve an elementary macroeconomic equilibrium in order to avoid the destructive effects of high inflation;
- price liberalization should be done only with a reasonable degree of macro-stability (to avoid vicious circles of price spirals);
- it is a mistake to liberalize prices and foreign trade in different moments (something else is the liberalization of the capital account of balance of payments);
- transformation process has no meaning without early privatization. It must be widespread. It must be fast (to shorten the “pre-privatization limbo”). It must be done without waiting for the much needed restructuring of firms. It must be done without waiting for the emergence of domestic capital – nonstandard concepts as “voucher privatization” are, therefore, inevitable;
- the institutional framework of the market economy is an important contribution to the success of reforms, but the institution building is an endless task. It is impossible to wait for perfect institutions. It would be wrong to stop deregulation, liberalization, desubsidization, privatization and other reform measures waiting for the arrival of fully developed institutions.

My more comprehensive discussion of these issues is to be found in my contribution to the **Transition in Perspective Project** prepared by the Peterson Institute for International Economics, in which your rector, prof. Djankov, has been very active. The book with papers prepared by well-known reformers from the 1990s will be published in the autumn.²

3. The third precondition for the success of transition was the ability to explain it, including its inevitable costs, to the people. They have to believe in the transformation process, they have to become co-players. They have to give it elementary political support. This was probably the most difficult task and I guess Yegor Gaidar would agree with this statement.

² V. Klaus, The Spirit and the Main Contours of Czech (or Czechoslovak) Post-Communist Transformation, forthcoming.

It was twenty, in our case twenty five years ago. We have different tasks and face different challenges now. The individual post-communist countries have – for many subjective and objective reasons – reached varying levels of maturity of their economic (and political) developments. I don't intend to mark them. Some of these countries are “normal” market economies and political democracies already (normal in European sense, which means they are very far from free markets and full-fledged parliamentary democracies). Nevertheless, **they have the transformation task behind them already.**

Some other countries are still “on the way” to achieve this status. According to my reading of the reality, Russia belongs to this grouping. I have no recommendations what should be done here now. And I have no ambitions to do it. That would be a totally different topic and, in addition to it, I am very cautious (if not hostile) to the would-be well-meant advices from abroad. I don't like the very profitable branch of industry called consulting. The experience tells me that the marginal effect of it is asymptotically close to zero.

Some of these countries have not completed the whole process; some made the institutional transition but the markets (political and economic ones) are still shallow and, therefore, inefficient; institutions remain weak and malfunctioning; property rights are still questioned and insecure. **That can be changed only by evolution.** There is no “rapid effect medicine” which could solve this immaturity. To discuss these issues would go beyond the limits of this ceremonial lecture.

I came to Russia from Central Europe, from Prague, from a country which has very early more or less solved the transformation puzzle, from a country which is a part of the European Union, of this – in the eyes of its acolytes and worshippers – future, if not already today's, paradise on earth. I see it differently. I see its inefficient, extensively paternalistic, by environmentalism burdened economic system which makes healthy economic growth impossible.

I see its already long-time lasting sovereign debt crisis which was brought about by the unfortunate, only politically motivated Euro experiment, by this revolutionary attempt to stop history. It reminds me of the past. The communists also wanted to eliminate the validity of economic laws and wanted to politically mastermind the economy. It did not work. I see also the EU post-democratic political arrangements based on the suppression of nation-states which represent the only entity where democracy is possible.

The substance of my polemics with current European arrangements is based on the criticism both of the negative effects of the ambitions to **economically centralize and unify the European continent** and of the underestimation of negative consequences of **the undemocratic suppression of nation-states in favour of pan-European governance.**

The economic stagnation Europe is facing is not a historic inevitability. It is a man-made problem. It is an outcome of a deliberately chosen and for years and decades gradually developed **European economic and social system** on the one hand and of the more and more **centralistic and undemocratic European Union political institutional arrangements** on the other. They both and especially **they together** form an unsurmountable obstacle to any further positive development. What we go through is not an accident or a misfortune. **It is a self-inflicted problem.** It is a self-inflicted injury. Hundreds of small, at first sight innocent details have metamorphosed into a serious systemic problem.

Not less important is the fact that the excessive and unnatural centralization, bureaucratization, harmonization, standardization and unification of the European continent has created a deep, more and more visible **democratic defect**, not just a democratic deficit as it is euphemistically called. The end result of this is that **we can't speak of democracy in Europe any more**. We entered a post-democratic or semi-democratic era which was, of course, always a dream of socialists of all colours. This may become in the long-run an even bigger problem than the current economic stagnation.

European monetary union is nothing else than an extreme version of a fixed exchange rate system. As an economist, I have to argue that **all historically known fixed exchange rate regimes needed exchange rates realignments sooner or later**. Eliminating this powerful – and for centuries functioning – adjustment mechanism was **a naive attempt to stop history**, something which all the constructivists, central planners, manipulators and dictators always wanted to achieve. Unsuccessfully.

My European experience is another reason for my reluctance to give any recommendations here today. I am convinced that I should concentrate on giving recommendations there where I live.

Thank you for your attention, and, once again, thank you for giving me the honour of being here with you today.