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## **Deloitte Speech: The Czech Republic after its transition and after its integration into the European Union**

1. Thank you for giving me a chance to speak here this morning. I am glad you decided to make your important gathering here, in Prague, in the Czech Republic. I am sure it was a good choice.

2. You came to the Czech Republic, to the country which – already more than seventeen years ago – succeeded in getting rid of communism and in dismantling its institutions, to the country which – in the couple of years that followed our Velvet revolution – quite smoothly and rapidly established a standard constitutional system: free and open society, full-fledged parliamentary democracy, market economy. As always and as everywhere, the political and economic systems in our country are far from perfect but they are very European – which is, of course, a mixed blessing. You came to the country which became – again, after half a century detour – a firm part of the Western world and which joined its main institutions (OECD, NATO, EU).

3. One point should be made strongly – **the transition from communism to free society is over**. We are not somewhere in-between. We rejected all kinds of third ways. The transition was relatively short, much shorter than most of the people here and elsewhere expected, and it was a costly process. As we – the pupils of Milton Friedman – know, there are no free lunches. Our experience tells us that there are no free far-reaching reforms, no free transitions, no free fundamental systemic changes either. To say that is rather simple, but important and non-trivial conclusion.

In our country and elsewhere, there have been dreams about realizing such a radical restructuring of the whole society without any costs, dreams about going immediately and steadily only upwards. It is not possible. Looking at the development of the national product, the J-curve is inevitable, and, similarly, after fifty years of fixed, administrated, totally irrational prices, large, but temporary inflation surge is inevitable as well. A proxy indicator, the sum of GDP loss and of the rate of inflation (conceptually similar to the unemployment-inflation index which was popular in the stagflation era of the 1970's and 80's) shows that the Czech Republic – at least during the first stage of transition – had achieved the lowest figure in the whole post-communist world.

4. In the following stage, at the beginning of the post-transition era, in the second half of the 1990's, we, however, suffered **an unnecessary setback** which was partly home-made (a consequence of the politically motivated fight between the central bank and the government), and partly the impact of the South-East Asian (or emerging markets) currency crises of that period. This episode was an unpleasant surprise for almost everyone and it resulted in a GDP stagnation for the period of the next 3-4 years which meant the interruption of our catching-up.

Since the beginning of this decade, our economic growth has been relatively very fast (in European terms), reaching 6% in the last two years. There is no visible

**domestic** reason for a new slowdown.

5. As compared to the early postcommunist era, when we were basically preoccupied with ourselves, **the external side** of our economic performance becomes more important now, especially in two respects:

- the economic growth in the rest of the world, especially in our main export markets;
- the constraints connected with our membership in the EU, or to put it more explicitly, with economic growth restraining institutions and economic policies in the EU.

6. It seems that the second aspect is more relevant than the first one now. Due to our lower labour costs and due to our rapidly growing productivity we succeeded in penetrating even the very sluggish EU markets. The average annual rate of growth of exports in the last 10 years was 13,3%, of exports to the EU 14%.

The continuous appreciation of the Czech crown, rather surprisingly, does not represent a problem, yet. If we take the average exchange rate of the Czech crown vis-à-vis the US dollar during the 1990's (which was 30,7), the crown is almost one third stronger now.

7. Much more important is the impact of EU institutions and policies. **The overall positive impact of our opening-up and of our growing economic integration with the EU countries, which started immediately after our Velvet revolution, have been already "consumed" and most of it happened before our formal entry into the EU three years ago.** It may be surprising to some of you, but the membership itself gave us no important additional benefits. Definitely not financial ones.

**We know that in the long-term not the fact of membership, but the impact of the current EU socio-economic model becomes crucial.** It brings me to saying a few words about the EU integration process.

8. **The past 50 years of the European integration have been usually considered to be a success, even if it is very difficult to statistically measure it or to prove it.** We all know that there have been many other unique, unrepeatable historical as well as much more important evolutionary global factors which were influencing the economic (and not only economic) performance of the EU member countries at the same time. This is not very often explicitly discussed and recognized. All progress of that period is usually attributed to the existence of the EU.

What I consider important is the fact that the concept (or model) of European integration has been fundamentally changing over time. With the benefit of hindsight, and with the courage to generalize, **I see two different integration models (or methods of integration) in Europe in the last 50 years.**

**The first one I call the liberalisation model. It was characterised by an inter-European opening-up, by the overall**

**liberalisation of human activities, by the removal of various, in the past created barriers at the borders of countries as regards the movement of goods and services, of labour and capital, as well as of ideas and cultural patterns. Its main feature was the removal of barriers and its basis was intergovernmentalism.**

**The second one, which I call the interventionist and harmonisation model, is characterised by enormous centralisation of decision-making in Brussels, by far-reaching regulation of human activities, by harmonisation of all kinds of "parameters" of political, economic and social systems, by standardisation and homogenization of human life. The main features of the second model are regulation and harmonisation orchestrated from above, and the birth of supranationalism.**

**I am frustrated that the people in Europe do not see this fundamental metamorphosis sufficiently clearly and especially do not think about its inevitable consequences. I am angry with politicians and their fellow travellers that they do maximum to hide it and to make it fuzzy.**

**I am – as it is well known – in favour of the first model, **not** of the second. I am convinced that the unification of decision-making at the EU level and the overall harmonisation of societal "parameters" went much further than was necessary and than is rational and economically advantageous.**

I consider it wrong. **I am not satisfied with making only cosmetic changes.** I am, therefore, in favour of **redefining the whole concept of the European Union.**

**I suggest going back to the intergovernmental model of European integration. I suggest going back to the original concept of attempting to remove existing barriers among countries. I suggest going back to the consistent liberalisation and opening-up of markets (not only economic ones). I suggest minimising political intervention in human activities. Where this intervention is inevitable, it should be done close to**

**the citizens (which means at the level of municipalities, regions and states), not in Brussels.**

To summarize, I want freedom in Europe, not democratic deficit, I want democracy in Europe, not postdemocracy.

**The original European project to do certain things together** – in spite of all existing historical, political, economic, cultural or religious differences and incompatibilities – **was a positive and meaningful idea**. The question was and remains to be **how to do it**. The task is to do it in a way which brings more benefits than costs to the citizens of European countries and in a way which guarantees freedom and not suppresses it. This is – in my understanding – not the case now.

I know that it is politically incorrect to say it, but we are obliged to do it. At least I feel obliged to do it, here and elsewhere, in academic discussions, as well as at EU summits.

Václav Klaus, Prague, Hotel Hilton, May 18, 2007