Good afternoon ladies and gentlemen, welcome back to the Peterson Institute for International Economics. I’m Adam Posen, the Institute’s president. We’re starting a little late today because just everything in Washington is running late today. It’s a traffic nightmare. But we are, as with today’s topic, doing something of lasting significance. So the short term may not matter so much.

Today we’re here to release The Great Rebirth, Lessons from the Victory of Capitalism over Communism, assembled, edited and directed by my colleagues, Anders Aslund and Simeon Djankov. And, we will be having featured remarks by Leszek Balcerowicz and I will introduce each of them in a moment.

The Great Rebirth—I know we’re all getting tired of titles with the word “great” in them. I had one on the Great Recession some years ago which then got overtaken by a greater recession. But I think the word “rebirth” is a very valid and important word. We take for granted now in some ways, and especially in some of the western parts of Eastern Europe, that of course these countries had to follow a market path and of course they had to succeed and converge, but the reality is there was nothing of the kind, of course. There was nothing foreordained, there was nothing inevitable about that.

And it was a combination of the intellectual assessment but also economic leadership that got these countries, the millions of people of the post-Soviet era, into the world market economy into Europe—for many parts of them—and into capitalism as well as freedom.

And this book is not a celebration but, I think, an analytic appreciation, a distillation of that process. The Great Rebirth, I think, is going to be on everyone’s shelves for years to come because Anderson Simeon’s vision was to bring together the key economic policymakers, the people who were both economists, thinkers and doers to on a country by country basis.
reflect on what actually they achieved and how they achieved it or why they didn’t get to achieve all they would achieve.

And so, this becomes a unique historic document as well as an important set of analyses and we’re very proud to be publishing it. We have received support for this from a number of foundations involved in Eastern Europe including George Soros and The Open Society Foundation, Petr Aven and the Gaidar Foundation.

But of course, we have done this all on our own intellectually and put it through the tests and retests of our refereeing process. Not everyone is going to agree with what’s in here. I had to write a note to one of our funders saying, “Well, it came a little more washy and consensus than you would have liked, but I think it’s well argued.” And then today, we can have the debate and some of you can argue back in the other direction.

So it’s my privilege to initially—I will do the introductions all at once and then turn to the talk—to bring up Leszek Balcerowicz who’s currently a professor at the College of Europe. As I think all of you know, he is one of the true heroes of all of us in the transition. He was the chairman of the National Bank of Poland. He was the Deputy Prime Minister of Finance, Minister of Poland at the critical moment. He implemented the plan now known as the Balcerowicz Plan, the transformation involving Shock Therapy in the 1990s, and of course, most importantly of all, he served many years as a member of the board of directors of the Peterson Institute for International Economics. Leszek will give us the unique perspective that only he can give, but meaning not just personal, but analytical.

Will then follow with remarks by Anders Aslund who of course has been a senior fellow here at the institute since 2006 so he continues to be an adjunct professor at Georgetown University, he’s previously worked to a number of other think tanks in Washington. He’s been an economic advisor for the government of Russia in the early ‘90s and the government of Ukraine from ‘94 to ‘97 and maybe taking on some role again in the Ukraine situation as it unfolds. We have a manuscript in process from Anders responding to the Ukrainian crisis. He’ll be giving a bit of a preview of that drawing on the lessons taken from this book that he has put together. That book will be out early in the New Year.

And finally, before opening up to the group discussion we have Simeon Djankov who is now visiting fellow at the institute. He was our second annual Sunrise Foundation lecturer last year. Recently, he served as Deputy Prime Minister and Finance Minister of Bulgaria. From 2009 to 2013, he was distinguished career at the World Bank. Before that, he was the founder of the World Bank Doing Business project and he too will be leading us through how today’s politicians, today’s generations, today’s
challenges in Eastern Europe and those people who doubt some of the lessons and benefits of transformation that we talk about are making mistakes perhaps in today’s world.

So, thank you all very much for joining us what should be a fascinating event. And now, if I could call on my old friend and hero, Leszek Balcerowicz.

[Applause]

Leszek Balcerowicz: Well, thank you very much. First of all, I would like to thank the institute especially Anders and Simeon for organizing a wonderful conference in Budapest and preparing this book.

I was asked not to speak as a researcher, but as a former policymaker who hopes to be still a researcher. I perhaps should explain that I have a function of Governor of a Central Bank and Deputy Prime Minister in succession, not during the same time. And that perhaps I have a second compact of experience because first, I was nominated Deputy Prime Minister, the Minister of Finance in the first Polish noncommunist government, which was the first noncommunist government in the former Soviet bloc.

And I had this function between September ‘89 and December ‘91 and I was in charge of stabilization and reforms in the Polish economy. And then I had the same function and the same mission, between November, ‘97 and May, 2000 under very different political conditions. And finally, I had the function—I was the governor of Central Bank of Poland between early 2001 and 2007 when we start and the inflation was above 10% and we finish, it was below 2%.

Now, I would mention a few points about in a comparative way in about each of these periods. But let me first say that in any job of this kind, there are three aspects. The first is intellectual or analytical. So, if you are in charge, you would have to know what is the mission and what are the ultimate ways of fulfilling it. The second is managerial, so the team. And the third is political, how to push a program through the political system.

And the relative importance of these three aspects differ depending on the situation. So in every case, in every country, managerial and political aspects are very, very important. And, if their programs fail, they usually fail not because of the technical understanding what should be done, but because lacking management skills and political economy considerations.

Now, in the first period in Poland, this managerial and political aspect matter a lot, but some technical or intellectual problems were present too
because Poland, as you might remember, was the first country to move to and from bankrupted socialist to open market capitalistic market economy under conditions—under very difficult conditions and not everything was intellectually prepared.

So the second problems which were never discussed, for example, how to privatize an economy which is totally dominated by state ownership. And experience of [inaudible 00:08:43] the most radical privatized way of limited importance because in Great Britain, when the Iron Lady started, state ownership accounted for less than 20%, not 100% or 90% and how to do it fast. This was one of the very intellectual challenges. In another one, it was obvious that if you have high inflation like in Poland in the second half of ‘89, inflation ranged between 20% and the 40% a month, then you have to be very tough on stabilization and this is universal. You have to stop printing money at such a rapid pace, but how does the state owned enterprises will respond to this necessary tough stabilization could not be exactly foretold? And should the [inaudible 00:09:34] restraint be added to stabilization or not? This was also under discussion.

So there are more intellectual problems in the first period than the later periods, and I would say countries like Ukraine who face both the possibility and the necessity of reforms, they have a lot they can draw of enormous experience of the past. So technical issues, they are not the most important issues and they do not need a lot of technical advice. So, they need a good theme with a strong political mandate, but coming to Poland, I was asked in late August, ’89 for then Prime Minister Mazowiecki to take to be in charge of stabilization and transformation program. And with strong hesitation I agreed because of three reasons. Without these three reasons, I would not have accepted it.

First, because by chance I was interested in radical reforms in other countries and in the late ‘70s I created a very young team and we worked on that in the ‘80s, and this was a hobby. We never dreamt that it would be useful during our lifetime. So that conclusion is: From time to time it is useful to have useless hobbies. Meet my work. So in a way, the homework, the basic homework, was done. Of course, there were a lot of details we’d need to fill in, but the basic structure was prepared.

Second, there was a team as I mentioned. I created and worked with a team and the team was supplemented by some selected officials in the administration and the team was very cohesive, competent and highly motivated as esprit de corps. Poland became free under the conditions of economic catastrophe and the mission was clear: Pull Poland out of these conditions and put it through reforms on the path of accelerated economic growth so as to catch up with the West.
And now in approaching this mission, I used a very simple scheme, which consisted of three elements. First, the diagnosis, which was simple: an economic catastrophe; it turned out that the economic situation was even worse than we knew. Then, what sort of a system should we introduce so as to make it possible for Poland to catch up in the West? And this was not very difficult because you can draw from many established, not necessarily from macroeconomic books. Macroeconomic books mainstream was of very limited importance for responding to the basic questions because mainstream economics in the West was institutional. They disregarded institutions and they would sometimes gave bad advice, but if somebody went beyond this conventional economics then one could formulate the basic features, a system capable of accelerated growth should display. Like predominantly private ownership, lots of competition, which included of course opening to western countries, stable market economy, moderate taxes, good justice system, et cetera, et cetera. So, this was a guiding post.

The most complicated thing, as you would expect, was transition. So how to make a transition from this very difficult situation to a better system? And as I mentioned, there were some intellectual problems, other were managerial problems and there were political problems. Now, in the first period managerial problem overcome because I had already a very good team.

And, frankly speaking, I could have—could not know how would I manage because this was a small team and my formal managerial position was just a secretary of a scientific institute. But it turned out that somehow I can manage and managing the initial economic catastrophe and with this mission required a lot of things.

First, some simple things. Meetings could not last more than one hour to two. At end to end, you have a much better solution than at the beginning so you have to be able to squeeze information out to the people. Very, very important, okay. Second, not everybody could call you. So there was a very short list; it included my wife when she was present, and the president. All other people were put on the waiting list.

Third, focus on the essential. I could not avoid receiving many delegations because people were interested what Poland was going to do, but I tried to keep it to the minimum and my message was: we are going to introduce radical reforms. And we even presented these intended reforms in the third week. But to the strengths and the chances of success, we needed the support of the West, first of all, foreign debt reduction. Poland was very heavily in debt and I thought that without debt reduction would be very difficult to succeed and finally we got 50% debt reduction in net present value terms.
Now, I did not have many doubts about the strategy of transition, not [inaudible 00:15:11] strategy. Based on my previous studies, I conceptualized a choice like in the following way: first, gradual, step-by-step, delaying changes. I thought it was completely hopeless, no chance, waste of time.

Second, radical, sometimes called shock therapy. Meaning that you move fast, you prepare your program very fast and then you move fast on a broad front, which meant stabilization, putting down inflation, massive liberalization of the economy, massive including foreign trade liberalization and abolishing of most monopolies, which was very, very important. Deep concentration, and at the same time, deeper institutional change, which included predominantly privatization. Privatization of the United States on enterprise, but this deeper institutional change, by necessity, took more time than stabilization and liberalization.

So, there was a two-stage transition. First, achieving a sort of socialist market economy, meaning state enterprises were predominant, and then, complete privatization.

Now, so we tried to introduce this. I must confess that the then prevailing discussion in western scientific literature about gradual versus shock therapy were worse than useless. They were harmful, absolutely harmful. This was done by academics who had no idea of the socialist economy and they just constructed simple mathematical models which said nothing in practical terms. There was also of useless or harmful discussion about whether institutions were neglected.

And this was a sort of accusation of radical reforms. They said, “Well, overlaid the importance of stabilization.” Those people usually define institutions in a very narrow way so that extending freedom was not an institutional change and [inaudible 00:17:20], but they were pretty influential in the media. They said, “Well, you neglected the institutions.” Of course, it turned out this was complete nonsense because countries which are most radical with stabilization and liberalization are the also most radical with deeper institutional change. So not everything, which was recommended by economic establishment in the West, not to mention economic establishment in our countries were useful. Were many, many not useful comments.

Okay, if you launch reforms under initial catastrophe, you have to face risk and not everybody is capable of facing risk. You know can lose, but you try to win but you should be convinced by some previous studies that he who have chosen a different approach, a gradualistic approach, you
would lose for sure. And comparing these two options was for me a very important source of psychological strength to continue.

Well, also, there were some unavoidable bad news. Inflation turned out initially to be higher, recession turned out to be deeper. In earlier 1990, later we learned that statistical apparatus measured only what was the [inaudible 00:18:39], state ownership. This was not bad will, it was just they are constructed. So their initial figures were much worse than the later figures, but it were the initial figures which were conveyed to the public.

So another simple conclusion one has to persist in the face of many, many pressures who want you to relax. I can you tell that we started the program on the 1st of January 1990 and on the 7th of January, I already got a letter from the official trade unions urging me to abandon the program because they said, “It’s obvious that it is a catastrophe.” And then some ministers in the same mouths convey a similar message.

Now, let me now comment very briefly on the second period: ’97 to 2000. Now, this was a very different period in the sense that the Poland economy was much more stable, but the reforms the in the previous three or four years were very slow and we needed accelerated privatization and some other reforms, and we also needed fiscal consolidation in order to avoid the growing current account deficits.

Now, in ‘97, I was a leader of a free market party and there I have won elections in the most industrialized region of Poland and I was not pretending that I’m a populist. I was just a free market liberal in the European sense. There were many minors, I don’t know how many voted for me, but there was enough people who voted for me, so I won the elections, which shows [inaudible 00:20:27] selling this only to show that it’s positive sometimes to appeal with free market message coined not only in technical terms. You have to express it in terms of moral terms, work, savings, old fashion virtues could be solved, can be solved.

Okay. Now, I created a coalition with much bigger partner, which was—it served a coalition centered around trade union solidarity. And together, we managed to push several reforms. First, accelerated privatization extremely important because in ‘97, the banking sector in Poland was dominated by state owned banks. If we did not accelerate privatization even we’re in the same situation as Slovenia, which postponed privatization and had a collapse.

Because of misallocation of credit in the state on banks, we introduce a deep pension reform. We have rationalized what we call here the social security system, something which has not been done until this moment in
the US. We introduced the second pillar, which was a funded pillar. Unfortunately, it was reversed later in Poland and in Hungary by [inaudible 00:21:43], which shows you now the importance. It is difficult to launch reforms, but it also sometimes difficult to defend reforms. The job does not stop with the launching reforms.

Okay. And we’ve introduced a massive program of restructuring of coal mines. Many of which were loss-making coalmines, lots of them. I can mention that I enlisted this apart of the World Bank hoping that the World Bank would press for privatization and I was disappointed. I was very much disappointed. They did not press for privatization as I hoped. They just wanted us to close the mines which was correct. So we are still left with a state owned company which employs 50,000 miners and, as one would expect, makes losses. But, they have 400,000 miners in 1989. So, this [inaudible 00:22:41] another 100,000 miners.

Now, I could not count on special political factors, that euphoria after liberation. I have to use different techniques to push reforms which was not always …. First principle attack first, be prepared. So, for example, when we learned that the medical profession wants to have much higher spending as in most countries.

So, in the minister of finance, I have a very good team, young team who’d prepared a wide book on the waste, discussing there and presenting the waste in the health service. They were put on the defensive. Then, we were—you had to be prepared for attacks you can stop. For example, when we decided to eliminate pathological tax breaks for disabled people who benefitted mostly the entrepreneurs, they organized a demonstration of disabled people in front of the Minister of Finance in their wheelchairs, but I was not shocked because I was expecting that. So, be prepared.

Third, seek allies, make coalitions. So, when trying to enforce the restructuring of mining, I found out that localities where the mines were located were very much against the miners, which was surprising because the miners were not paying taxes. So of course, we had made allies and they were very different kinds of allies. So, with this and communication strategy, when you cannot count just on speed and of—on extraordinary factors like that which prevailed in the first period of Poland’s transition, you have to be very good in communication and have an excellent communication team. So, I learned how to appear on TV. This was not my initial vocation, but I have to learn that.

Okay, so together, we managed to accelerate—this was another period of accelerated reform in Poland which contributed to some extent to the future economic structure in Poland. Let me end with a few remarks about central banking. So I resigned my—the chairmanship of the party, and
then a few months later I was elected by the Parliament, the governor of the Central Bank of Poland and the job was simple: Inflation was above 10% and had to be brought down to around 2%, while preserving or even strengthening the independence of the central bank.

Now normally, it is a difference, I think, but in the job of central banking and the job of reformer in the government. As a reformer, especially in the second period, you do not feel intellectually insulted about what should be done. You have to reduce spending. It’s not philosophical. You have to accelerate the privatization. They are not philosophical doubts; they are political, managerial and political.

But in a central bank which is independent, there is much less political uncertainty and much more intellectual uncertainty you’re dealing with. For example, you want to reduce inflation based on forecasts and not when inflation has already increased. That’s too late. So there’s a room for a lot of discussions and, to some extent, educated guesses, and for an economist it’s fascinating. But, I had also to fight.

So when I was a central banker, because our interest rate policy was not very popular with the government. The government wanted us to reduce interest rates much, much quicker. We wanted to be sure that inflation would fall, so we resisted this pressure and there were threats that if you don’t reduce interest rates much more quickly, they would add a couple of new members of the monetary council to the present membership, but it somehow resisted.

So, it was possible to defend even strength and the independence of the central bank and bring inflation down to below 2%. Summing up, I think let me stress in normal circumstances, the main dilemmas are not economic, not technical. It is not the problem you don’t know what to do. Perhaps now monetary policies were now intellectual problems. But I would say in practical terms, managerial, having good team, and political, being able to press with reforms or better policies in the phase of unavoidable resistance from various groups.

Thank you very much for your attention.

[Applause]

Anders Aslund: Thank you very much. It’s a pleasure to do this here today. I should say, first of all, the person who came up with the idea of this book is Simeon Djankov who came up to me a bit more than a year ago and said that he and I should do this book and the conference and the idea that we wanted to bring to give the great reformers, take the key cases of post-communist, economic reform. And, we have done it in two ways. We did nine country
studies simply taking the countries that we thought were most interesting for various reasons, and then five tendency studies.

And after we had come up with this idea, we went to Adam, who fortunately supported it strongly, so we are very happy about that. And Steve Weisman, our director of publications here, made sure that he and his team produced the book fast and well. So this has been in the works for just a year.

You might wonder, “What is this picture about?” And both pictures come from Moscow. At the bottom, you see Moscow at its very worst. This is a bread shop in the fall of ‘91 when you could not even find bread in an ordinary shop. And, the contrast, this is Moscow city, their financial central Moscow—which, admittedly, right now, is in collapse, but that’s another matter.

[Laughter]

Yeah. And, what I would like to do here today—well, I should mention first is that the five countries that stand out to us as the successful reformers are first of all, Poland and there of course Leszek Balcerowicz is the author of the Balcerowicz program that was then replicated in other countries. The competitor from early on was the Czech Republic with Václav Klaus who went on from being minister of finance to become prime minister and president. So both were at the conference and contributed substantial articles to this book.

The third country, what I consider the best reform of all, is Estonia where reforms were run by Prime Minister Mart Laar who has also contributed an article to this book, but unfortunately, he’s barely 55, but he had a stroke two years ago so he’s paralyzed but he can write. He can’t move much, sitting in a wheelchair. And then Slovakia, which is interesting because that was a late reform. It’s one of the catch-up reforms. And in the 2000s, Slovakia has beaten all of the other countries in terms of economic growth and that was done by a team of Prime Minister Mikuláš Dzurinda and the Minister of Finance Ivan Mikloš so we had Ivan Mikloš to write an article about the experiences in Slovakia.

And then, Georgia, which is probably the most amazing reform. Here, President Mikheil Saakashvili came in, together with Minister of Economy Kakha Bendukidze, and turned the country upside-down. This was considered a fail state until they came in and they put it in into order, not instantly, but it was a slightly different reform that they took piece by piece. For example, sacked all the 6,000 traffic policemen in one go and then gradually built up a new traffic police that were not corrupt. So, that’s the most radical approach so that we had them writing an article for the
book also—unfortunately, Kakha Bendukidze, one of the greatest reformers, died less than a month ago. So, that’s a great loss, only 58 years old.

But, let me move on. Oops, it doesn’t move. Oh, here it is. So, Simeon and I sitting at this conference in Budapest with 45 people who had participated in the various ways in the reforms, several of them are here today. We sat and thought, “Which are the most important lessons we hear?” And this is what we came up with, which is very much the main points in our introduction of the book. So this is our choice of what we heard.

The first point, as you have heard now from Leszek Balcerowicz: speed is important, front-load reforms. There’s never any reason to wait. It’s better to do something that you don’t quite know than wait with [inaudible 00:32:59].

The second point is that people’s behavior cannot be changed. If you’re an old communist apparatchik, you will stay an old communist apparatchik, at least for a long time, and we don’t have time. So, you have to change people instead. Rejuvenation is vital. So the two most radical reforms Georgia and Estonia had the youngest ministers. In the first reform government in Estonia, there were three ministers who were younger than 30. You need youth to change things in this situation.

The third conclusion was that the dominant economic problem is rent-seeking and corruption. This has become ever stronger over time. And I should mention here [inaudible 00:33:47] article The Winner Takes All from 1998 is the fundamental insight for [inaudible 00:33:55] article about this. And, that really changed the view before many people thought that “It’s the workers, it’s the people who take to the street that are dangerous,” and it turned out not to be the case. It was the rich and the powerful. Or the people are now called oligarchs, but at the time, they were rather state enterprise managers who were the real danger to reform.

And, the fourth lesson is that extraordinary politics, a term that Leszek coined, is critical. You have a brief time when institutions don’t tie you up when you can do a lot of things, or I like Mart Laar’s term: to wait is to lose. If you don’t act fast, the old establishment will take over. That’s why the reforms cannot be slow. It’s a matter of what political force that wins because the institutions that are there are anti-reform.

The fifth point is that leadership matters most early on because then you have very weak institutions. And the reform leader, as you might notice, is normally one person. We talk about Gaidar program in Russia, the Balcerowicz program, the [inaudible 0:35:21] reform, et cetera. It’s one
person who gives the name and normally it’s not the prime minister, certainly not the president. It’s normally the minister of finance. And, the most difficult thing to reform is the state because the state has so many functions. Enterprises are simple, they work for profit and if they don’t, they go bankrupt. So, enterprises, you just need to prioritize. States have so many different functions, but can’t be measured.

And, the seventh conclusion, which I would particularly say Simeon brought out, is that the secret police is the greatest threat and it’s not only Putin. It’s—the secret police runs many of the countries, Bulgaria, Serbia, Kirgizstan. So, this has turned out to be the most vicious force. After the oligarchs are gone, the secret policemen have taken over.

The eighth point is that democracy is vital for success of market reforms. This is very much a consensus point and there’s nobody who stands out for [inaudible 00:36:41] reforms—oops, sorry. I’ve forgotten that—[inaudible 00:36:45] any longer.

And, the ninth point that I hadn’t quite expected is that it’s nearly impossible to know when reforms become feasible. This was, in particular, Ivan Mikloš, the former minister of finance of Slovakia who pushed it that here they came in or rather got reelected in 2002 and carried out very radical and successful reforms on a broad front in Slovakia. So, I asked, “How could you do it? Nobody did reforms during this boom period. And Slovakia did massive reforms. Why?” He said, “We were prepared and we wanted to do it and we all of a sudden got a political mandate, and we had not expected it,” they said, but they had prepared for it. So the answer is, you have to be prepared. You never knew when the reforms then become possible.

And a 10th conclusion is the main force of reform must be national, domestic, and here, I should particularly turn to John Odling-Smee, the former director of a European II Department sitting over here who is also with us in Budapest. And, he emphasized that the IMF, which is the strongest outside force cannot do reforms on its own. There must be people in that country’s leadership that want to do reform, otherwise nothing can be done. And that, of course, naturally leads the thought to Ukraine right now. Yesterday, Ukraine got a new government that wants to make reform. The question is if they can really do it. I think and hope and think so, but it remains to be seen.

And, the 11th conclusion is quite obvious. The worse the situation, the more radical reforms are needed, but they’re also more difficult. And my particular example here is Russia. At the end of ‘91, the Russian energy prices, oil prices were 1% of world market prices. Gaidar and all the rest of us who work with him pushed for full liberalization of the oil price, but
[inaudible 00:39:06] said, “Sorry, only five times.” And that is not enough. And that meant that in ‘92 and ‘93, all—and particular ‘92—everybody who got rich in Russia got rich on exporting oil, buying it for a fraction of market cost on the world market. That’s how you become really rich in one go and then you become [inaudible 00:39:33] off the world and become an oligarch.

And then, returning then to Ukraine today, the gas price in Ukraine is one-seventh of what it should be. That is the consumer price. The producer price is one-twelfth of the market price. So, what I’m arguing today in Ukraine: do away with this substance instantly and then give social compensation to the poorer half of the population in cash instead.

And then, on final point, reversal of structure reforms, new concerns mainly in Russia and Hungary and this I leave to Simeon. And let me just end with this picture, which is what to me best sums up the reform experience on the Y-axis you have Freedom House’s index of political rights and civil liberties and on the right, on the X-axis, you have Transparency International Corruption Perception Index. And what do we see? The countries very nicely line up in three groups.

In the blue circle, you have all the new EU members. They have carried out substantial reforms on full democracies and they have quite little corruption. It’s only Georgia that has managed to fight corruption as well as the EU countries. And that’s the optimal equilibrium.

And down to the left, you have a suboptimal equilibrium with most of the post-soviet countries that are deeply corrupt and if you want to keep corruption really going, you need an authoritarian role to keep it there and that’s how it functions. This is Russia and Central Asia. And interestingly, we have four countries in between: Moldova, Georgia, Ukraine, Romania. This is the EU’s Eastern partnership. This is the countries where have not decided where they belong and this is what the struggle is about today.

Thank you.

[Applause]

Simeon Djankov: And last from me, I will be very brief and just talk about one specific point from our book, which is the last point that Anders mentioned. When we started working on this project about a year ago, we thought of it mostly as a retrospective historical project to record how reforms were done in the countries that were reforming, to draw some lessons from this, mostly from other regions—at least, this is how I thought about it—so that when, let’s say the Middle East decides to reform, they have some lessons to
reform. When Central Asia decides to reform, they have some lessons to draw and so on.

But in the course of writing this book, we discovered that there are some issues that are not either historical or retrospective, but are very much alive now, and especially this issue of reversal subreforms. So I will just, literally in a few minutes, talk about this issue which lately, particularly with examples of Russia and Hungary, has become not just an issue for the former socialist countries but, I would say, a global issue.

So, some examples of reform reversals, this is all from the book. Well, we know there are many reform reversals in Russia and different scholars put the start of reversal somewhere in 2003, 2004, so already a decade of such reversal. I’ll just mention one obvious. One which is that, in this past decade, there was a very rapid increase of state ownership in both the financial sector and the resource sectors in Russia so there were some initial privatization steps, projects, and about a decade ago, the share of the state in both of these sectors was less than half. If you look now at the financial sector in Russia, it’s about 70, 70-some percent state ownership in terms of assets. And if you look at the oil and gas sector, the concentration in the hands of the state is more than three quarters. So there has been a very rapid and continuous change in terms of this policy. There are many others, as I mentioned, in Russia.

The same is the situation in Hungary. More recent in the last five or so years, I’ve pointed some examples here. The nationalization of the pension system, which in—not in the very early years of transition, but in the late ‘90s like several of the countries in this region go to private second pillar, that was nationalized into steps by the urban government. And in Hungary, there are many other truly examples of nationalization of strategic assets. So, the national oil company, which was mostly privatized was bought back by the government at some fairly high prices. A new state monopoly on selling tobacco was established a few years ago again under the guise of a strategic sector selling tobacco and a number of other examples.

But Hungary and Russia—and this is the point I want to make—and their respective leaders Orbán and Putin are by now, sort of well-known global commodity for perhaps populous politicians, people who we don’t like particularly and hope that they will sometimes soon leave the political scene of their respective countries and open the door for others to come and to take the right path.

And the message that I want to draw today and show you just a few pictures is that even if Orbán and Putin leave—and eventually they will leave their current positions—it’s not at all clear that in these countries, or
for that matter, in a few other countries in the regions, that you are not
going to get the same or even worst populist politicians.

So before showing you some very recent data from Bulgaria just as an
illustration, I’ll just also quickly point out that there are partial
nationalizations of the pension systems in Poland, as well as actually in
Slovakia. And in my own country in the last year there was a debate, and
to my amazement, movement towards the topic that actually if we have
stayed on enterprise and they make losses, of course, we should subsidize
them because they are owned enterprises. So the past government, no
longer in power, but for 15 months or so, actually had a fairly active
program in subsidizing loss making state owned enterprises. Something
that, not just Bulgaria, but a lot of countries in these regions had not
thought of doing for at least 15, 20 years.

So what I’d like to convince you today with three simple pictures is that
what is happening is not just some random populous politicians who come
to power just because they are more charismatic than others, but there’s an
underlying trend. And this is a warring trend, which is why these types of
studies and this type of analysis are needed; not just to go like in history,
but to see what are some of the underlying issues are.

I should just mention in passing that other than the rise of populists to
power, which we discussed in our region, there are a few other, let’s say,
trends like the Eurozone crisis, the discontent with fiscal discipline who
brought [inaudible 00:47:47] in Slovakia or [inaudible 00:47:48] in
Bulgaria, in Serbia, there were quite populist government successive
governments until recently. But the point I want to illustrate is the loss of
memory of the evils of communism, central planning, the limits to
democracy, something that during early reform was very much present.
You could agree or disagree, but everybody had that in mind when doing
reforms. And how this has in the last quarter or century basically not
entirely disappeared, but certainly become much less of an agenda item,
much less of a prevailing view.

So, what I would like to show is three simple pictures from the last. They
were for the 25th anniversary of the start of transition, there was a big
survey—sociological survey, Poland, Bulgaria, a number of questions.
This was done less than a month ago. So just three slides to illustrate this.

The first slide is simple. So it is: are you familiar with Bulgaria’s
economic development or underdevelopment under communism? So, if
you go to young people, which is the leftmost column, basically, 80% say,
“We actually don’t know much about this. In fact, we don’t know at all
about this. We don’t know how difficult or not the economic situation in
Bulgaria was.” And only 2% say, “We are familiar basically. We have
studied this. We have knowledge of this.” When you go to the older generation, 60 and over, it’s the opposite, so they do remember this time, they do remember the economic hardships that we had to go through, but the younger generation basically has no memory of the economic—not just the economic success of failure, but the economic system that prevailed at that time.

This is my favorite, which is basically Todor Zhivkov who is one of this by the end of his tenure, very senile communist leaders. He was a communist leader for 30 or so years up until 1989, November 10th, 1989. Identical poll down in 1991 and about a month ago. So 1991, you ask the population, basically, “Do you approve of Todor Zhivkov? Is he a nice person? Is he somebody that you approve of as a politician?” Three quarters, 76% say “No, so we don’t approve of him.” You go forward in time to last month, you have the same question and by now, the majority of the respondents say, “Todor Zhivkov was actually an outstanding guy, a really nice person to have around.”

Participant: [Inaudible 00:50:31].

Simeon Djankov: He’s also dead by now, yes. But I’m sure if you do the same survey in other countries in transition, I’m sure you’d find the same results. So there is the loss of memory; worse, because of the loss of memory, basically this fairly evil people, he was not probably as evil as [inaudible 00:50:51], but certainly did his share of evil deeds in Bulgaria. By now, he's remembered relatively fondly.

Well, with this and this is the last slide what remains. So you have a loss of memory of what was before, you tend to almost romanticize the period, everybody was employed, there was no inflation because money didn’t matter; you couldn’t buy anything. Well, what do you think of the current situation of the post-communist development? And here, everybody has strong views. Half of the people basically say, “We don’t like. It is not successful.” And only 10% say that it’s successful.

Well, if you put these facts together, what do you have? Well, you have a very good base for the rise of populists. Not just in Russia, not just in Hungary, but in all of our countries. The past is not remembered anymore. The present is difficult. We are not at the level of Western Europe yet and it will be probably decades until we are there now. We need new messiahs who come and basically tell us that we are better than we really are. Who are these going to visit these people? Exactly, people like Orbán.

To go against this, to turn the tide on this, there are not only these types of analyses that need to be done, but there has to be a lot much more deeper thinking of “What is it? What are the instruments to change the views of
the population, the views of the current politicians so that if we have this meeting two years, five years from now and so on, we don’t have here Russia, Hungary, Slovakia, Bulgaria, Poland and so on, a long list of countries that have reversed previous reforms?”

Thank you.

[Applause]

Adam Posen: Thank you, all three, for passionate, important, pointed, and Simeon points out actually timely statements on the lessons of The Great Rebirth. Since we started a little late, I will yield my usual time of asking the authors questions and turn to the distinguished audience. We have as usual or we will shortly have a traveling mic upfront with Jessica and we have a standing mic at the back. Please come forward or identify yourself to me if you’d like to ask a question. Please identify yourself when you speak and please pretend you’re asking a question, not making a speech.

[Laughter]

Barry Wood: Barry Wood, economic columnist, Marketwatch. I would like to ask Mr. Balcerowicz, Mr. Djankov, but also Mr. Aslund. Are we in a new Cold War when we look at Russia and we used to put them with the reformers, now they’ve fallen back? And when you say that those four countries in the middle of your chart of those two poles don’t know where they fit, how do you see this unfolding? And finally, how do you solve the Ukraine problem when corruption is so endemic in that society and their challenges certainly are as great as Russia.

Adam Posen: I’ll phrase this question, Barry.

Barry Wood: Mm-hmm.

Adam Posen: Why don’t we go Leszek, Simeon and Anders?

Leszek Balcerowicz: Well, I think that with this action so far have changed or may change the geopolitical situation and this is an aggression against democratic Ukraine. Whenever you deal with an aggression, you always are facing risk. And one risk is when response is too weak. This may encourage further aggression. So I would prefer a stronger response even though there is not a guarantee of discouraging further aggression.

And, let me make one more remark. Ukraine in itself, is a very important country, but what is going on in Ukraine goes beyond Ukraine; it’s of geopolitical significance. I am sure that Chinese are watching how the West is responding, especially the US, to Putin’s action and they would
draw their conclusion depending how the West responds. So it is of utmost importance, absolutely of most importance. There are stronger responses and some of these responses have been supplied, not intentionally, by the free market to the US. I mean, Shell gas and Shell oil. And, this has contributed to decline, as you know, this put a pressure upon the rulers of Russia.

Barry Wood: Thank you.

Simeon Djankov: A short answer from me as well. I think, until about a year ago, most of us, myself included, thought that Eastern Europe, including the former Soviet Union, are like the rest of Europe moving towards democracy, moving towards market economies, they perhaps just need more time to get there, some countries more than others. And I think what this work has taught us in some of the examples that we’ve given is that it’s not like that so it is not a straight shot to full democracy and straight shot to market economies.

So it’s that in many of these countries apart from individual political leaders, they sort of quite discontent with how this process has gone, the transition process has gone. In some countries more than others, Russia is an example and hence this discontent breeds quite widespread populism in their politics, which in turn then can go to what you are suggesting of [inaudible 00:56:30]: Should we yet all go towards the West?” You have politicians like Orbán just asking this, “What’s so great with the West? What’s so great with Western Europe? Maybe we should do something else.”

And it’s not only Orbán, it’s not only Putin, there are a lot of other politicians—whose names perhaps we don’t know today, but we may know in a few years—that create this discontent, use it to say, “We should do something else,” and that something else indeed can be the start of a fight. I wouldn’t call it a war that so far we are very blasé about.

Leszek Balcerowicz: [Inaudible 00:57:08] but I think Putin is special.

Adam Posen: Mm-hmm. Special.

Leszek Balcerowicz: Because of his capacity. I don’t know personality, but capacity.

Adam Posen: Okay, let’s wrap this up there. Anders, can you—we have a lot of questions Anders, so can you be quite concise?

Anders Aslund: On Russia, this vote buying [inaudible 00:57:29] I think is really changing the picture of what is going on in—what has been going on in Russia. So, the old narrative has been that it was reformers that made some mistakes.
The new narrative is that this is the secret police coming back and working together with organized crime. And to draw the parallel, we don’t talk about—we don’t blame the democrats in Republic for not building democracy. We blame Hitler for building the opposite.

And I think that we are coming to the same, new narrative about Russia’s post-communist history. Of Ukraine, I have a book that you will get in three months’ time. Ukraine, what went wrong and how to fix it,[inaudible 00:58:26] degree on [inaudible 00:58:28].

Adam Posen: Okay. Over here, then at the back and then over there.

Mike: Mike University. I have a question for all of the speakers about debt relief because I think debt relief is very important for Poland and there are a lot of Western European countries that could use some debt relief. Who pays? Is it an investment? And what are the chances of it working like it did in Poland?

Leszek Balcerowicz: I’ll take this question on Ukraine.

Adam Posen: The gentleman behind [inaudible 00:58:56].

Leszek Balcerowicz: This is on Ukraine. Well, as I said in Polish case, seeking debt relief was part of the strategy. Well, the one hand we’re saying to the—our creditors that we intend, for our own benefit, and implement radical reforms. But to strengthen the chances of political acceptance of these reforms, I said, we need that relief so that people would be convinced that not all the fruits of their reforms will go to the Western creditors. So this was a political argument and economic argument. I think given that situation of Ukraine and providing that they launch reforms, I think they should get that relief.

Adam Posen: Yep.

Anders Aslund: Well, it’s also a question of what structure you have of debt. Poland had a lot of foreign debt and not domestic debt then it matters. Ukraine has 60% of a debt that’s held by the Central Bank and the Eurobonds is only one fifth of the debt. It’s about 15% of GDP. So for Ukraine, it would be little benefit and it would be a certain damage to reputation so it’s not obvious.

Adam Posen: Okay. The gentleman who was at the back who’s there and then that person.

Andrei Illarionov: Andrei Illarionov of Cato Institute. One comment and one question—a comment concerning the of the Russian liberalization a careful study over the period of ‘91 and ‘92 has shown that it was exactly Mr. Yeltsin and Mr. [inaudible 01:00:33] were pushing for the
full-fledged price liberalization in Russia and that it was exactly Mr. Gaidar who was trying to stop it. He was in favor of postpone liberalization from July 1st, ‘92, so six months later that it happened, and he was in favor of two steps in price liberalization with many, many exceptions including bread, grain, oil and many others. So … just the picture of Russian reforms is much more complicated than it is generally believed by many of us.

And my question concerning the very important graphics you have shown here about the evolution or devolution of the public perception about what was right and what is wrong in the transition. And it raises a very important question about the long-term success of those reforms because it’s going to be the public beliefs about past and the present is very important for future decisions, not only by political leaders, but the general society.

Since you’re absolutely right, the picture that you have shown for Bulgaria is very similar for many, if not all countries in transition. And it is very persistent; it is already for more about 10 years. This is a very clear evolution and this direction actually getting even worst. So, do we have or do you have any idea how it is possible to explain? This is a shocking development in public and social psychology in those countries and how those—

Adam Posen: Thank you. You’ve asked your question. Thank you.

Andrei Illarionov: Mm-hmm.

Adam Posen: No, no it’s Simeon actually.

Male Speaker: Will somebody would save me?

Adam Posen: No, Simeon, please.

Male Speaker: Simeon.

Simeon Djankov: Frankly, I don’t have a good answer. I’ve been expecting this, but the survey that is showed you is a very, very large survey. Bulgaria is a small country, not often you do such surveys. So I was frankly quite shocked to see how persistent that many other questions like this which to me are alarming. Why is it the case? I agree with you. We understand some of the underlying reasons. How to change that? I’m actually not sure because I’m still follow Bulgarian politics and what I see is actually many Orbán likes—not quite Putin since we don’t have the might—but many people who actually openly admire Orbán and say, “See, we should be exactly
like Hungary. We should show it to [inaudible 01:03:09]. We should show it to Brussels and so on.”

So, it’s a really imminent and present danger. And, how to resolve this, I’m not sure. Maybe Anders can resolve it for us.

Adam Posen: You can resolve it?

Anders Aslund: No, I wanted to take the first point. Of course [inaudible 01:03:23] I was in favor of far-reaching price liberalization. I was there. We pursued these conversations while you were there in another capacity. I saw it, I heard it and you have been rebuked on this point by so many, so I think that should be clear.

Andrei Illarionov: Anders, I was there also [inaudible 01:03:42] participated to all of the discussions. You [inaudible 01:03:47], I’m not [inaudible 01:03:48]. I was inside the government and [inaudible 01:03:50].

Anders Aslund: Why does everybody deny that it was as you said?

Andrei Illarionov: I don’t know.

Adam Posen: Okay. All right, I will—if both of you provide a link to something that resembles documentary evidence, we’ll put that on the website and then people can decide. The gentleman there.

Kurth Schuler: Kurt Schuler from the Treasury Department.

Adam Posen: Okay.

Kurth Schuler: The number one lesson of all of you is speed. So, is the experience of China—which is not discussed in this book—a counterexample?

Male Speaker: Okay, maybe I can start. So, one important Chinese not a democracy. So, if you don’t have a democracy, you have in my view a bit more time to stretch out things. Sooner or later, they’re going to be heard by that, but if you simultaneously have a democratic regime or move to democracy and have to implement reforms, you need to do it very quickly; otherwise, the political spectrum very quickly turns against you.

Anders Aslund: But I think China was not so gradualistic. China started in the late ‘70s with the economy dominated by agriculture. 80% of the population worked in agriculture and they dismantled the nonsensical Maoist communes and replaced them with quasi-private ownership. This was a property rights revolution which was not gradualistic. This could not have been repeated in Russia because the structure of Russian economy is
completely different. Agriculture covered a much smaller share and it was much more dependent on complex technology. So China was not very gradualistic, given the initial structure.

Adam Posen: We’re running out of time so I’m not going to let all three answer. Stein and then [inaudible 01:05:40].

Stein: Stein [inaudible 01:05:42] in the IMF. We’ve debated this a little bit in Budapest and I think partly you’re underestimating the value of your report for other countries. You mentioned a little bit like your lessons from [inaudible 01:05:51] and Central Asia, but if I’d take your lessons, it’s often dominated by speed and user opportunity. The same time we’re now seeing this divide between countries. And I think in part can be explained by the way it was done, not just the speed but let’s say take privatization, you can do privatization very quickly and give it to the insiders and create oligarchs and they’ll later by paying forward in terms of the vertical support for the things that you really want to do.

So, I think I want to get back to that thing that we discussed a little bit there, I think the way in which you do it, if you do it fast and that was quite a bit, I think you’re underestimating the lessons that you have within your own report and maybe I can challenge you on this on it now and ask you for a little bit more of details.

Adam Posen: Okay. Yeah, Anders, why don’t you respond to that?

Anders Aslund: Okay. Well, I think that what we heard in Budapest is it’s not so important how you privatize. It’s important that you privatize. That it was the dominant move that I heard that people were much less interested in discussing the technicalities of it that the breadth and the speed, that those will be the emphasis and then very much, the political economy of it.

And then, if you look up on privatization people complain about is Russia. Well, the big reform in Russia was privatization so the problem was that the other reforms were not undertaken. You’ve got the massive rent-seeking in Russia because of control of the commodity prices, oil and gas and metals and also of the exports. So, one of the fundamental issues is liberalize exports, and therefore, commodity prices early on. If you have got that down, frankly I don’t think it matters about how you privatize or not privatize. But this is what I heard as the dominant [inaudible 01:07:51].

Stein: All right.

Adam Posen: Peter.
Peter: Thank you. Peter [inaudible 01:07:56] at Georgetown University. Question for Leszek Balcerowicz. You mentioned that some of the Western advice for your own transformation was harmful. You used that word. Can you elaborate on the point what you have in mind and who you have in mind? And number two, I would like to know which economic school and which economic model economist you have in mind for your own program?

Adam Posen: Leszek, in the interest of both time and sanity, emphasize the “what” and not the “who”.

Leszek Balcerowicz: Well, okay, okay, yeah. Well, I mentioned—I said there was a lot of theoretical debate about gradual versus shock therapy in the mainstream literature, which I found it was a complete nonsense, complete. They disregarded Hungary [inaudible 01:08:48] socialist economy, which called were very radical approach. And, I also mentioned although we’ve got lots of useful advice from IMF or World Bank, I was very disappointed that there was no pressure for coalmining privatization in Poland when I asked the World Bank. I was not interested in the money [inaudible 01:09:12], but in the pressure. Money, [inaudible 01:09:15], pressure we didn’t.

[Laughter]

Adam Posen: Very good answer. I’m afraid I’m going to cut you off there. We’re already past our witching hour. Thank you all very much for joining us and please give your thanks to our three.

[Applause]