



## Capitalism 20 Years after the Berlin Wall

*Anders Åslund assesses the record of post-Communist Europe's transition to free markets and questions whether the United States has learned the right lessons from history.*

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Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics. Anders Åslund, senior fellow at the Institute, is here today to discuss—on the occasion of the 20th anniversary of the fall of the Berlin Wall—the record and outlook in what was once the Communist Bloc in Eastern Europe. Anders, thanks for being here.

Anders Åslund: My pleasure.

Steve Weisman: Anders, you are one of the world's foremost experts on these economies and have watched them since before the fall of the Wall and of the Communist Bloc. But it's a good moment to assess the record of how they've done in the last 20 years. How have they done?

Anders Åslund: Well, of course, this is an extraordinary success. A few years ago, people didn't know if it was possible to be a capitalist. Now, on the contrary we've seen that out of 30 former post-communist countries, 27 are now market economies. So you really need a very strong dictator who wants to block the transition to a market economy to succeed. And we also know how it should be done. There are three things that are essential; the three things that all of the radical reformists said: deregulation, financial stabilization, and privatization. And do it as fast as possible because otherwise you will have a lot of vested—all the interests that will distort the process to their benefit. The slower the reform has been, the greater the income inequality has become afterward.

Steve Weisman: Give me some examples.

Anders Åslund: If you'd take countries that have got really high income inequality—Kazakhstan, Russia, Ukraine—this is where you have the oligarchs. And the countries that have been most successful in building a broad market economy, democratic economy are Central Europe and the Baltic States. If you take one particular country that has been successful, it's Poland.

Steve Weisman: I was going to ask you about Poland because 15, 20 years ago, Poland was associated with the term “shock therapy.” Many people said that shock therapy was a good idea. Some said it was a terrible idea; that it would lead to a loss of popular support for these new reforms. What's the record?

Anders Aslund: Shock therapy worked and the more radical the reform, the better. So Leszek Balcerowicz was the minister of finance then and the real reformer in Poland. He really set the stage for how reform should be done. And afterward, Poland returned to growth much earlier than all the others. It had much more small enterprise development than anybody else. And also now in the financial crisis, it has had a much more responsible monetary policy before the crisis. So Poland is the only country in Europe that is growing this year; this is a true success. Poland has never been happier and better off in every regard in the last 20 years in its history.

Steve Weisman: Of course there's an irony, which is that these successes that you cite have come at a time of crisis in capitalism in what used to be called the West, certainly Western Europe and the United States. What is one to make of that? Is there a new consensus in Europe about mixed economies and economic models?

Anders Aslund: The world looks very different from Europe, whether East or West, than it does from the United States today. In Europe, it's the center-right that is winning in country after country. The center-right has never been stronger in Europe and it is....

Steve Weisman: As we saw in the German elections.

Anders Aslund: Indeed. The German elections where the Social Democrats lost 11 percent of the votes—that's significant. And you can say that social democracy is over because social democracy believes in the good state, and that's an untenable view.

Steve Weisman: Is that bad news for Obama, by the way?

Anders Aslund: Yes, I think it is because Obama could be described as a Social Democrat believing that the state can be good. And Europeans have now stopped believing that, but they still want a substantial social welfare. So what we are seeing is that the public sector declines in Europe and that's what the center-right stands for, not in the radical but the trimming of the state.

Steve Weisman: And we may see that in Britain, for instance, in the next election.

Anders Aslund: Indeed. So the two countries that have really failed, that's the United States and the United Kingdom. These are the countries that have real problems. And for the rest, you can say that Europe perhaps had a banking problem, too loose monetary policy for a long time. And Eastern Europe had only a current account crisis; too much money coming in because the conditions were too good, plus a bad exchange rate policy.

Many countries, in particular the Baltic countries, had fixed exchange rates and now they will learn this lesson: Either adopt the euro early on or move toward inflation targeting with a floating exchange rate. So I think that what we are seeing in Eastern Europe now is a repetition of the East Asian crisis in 1997/1998, which [has strayed between] a sharp decline and then a sharp rise. And two years afterward, nobody could understand what people had thought about in 1998

when they thought that the East Asian miracle was to disappear. We now see that the East Asian miracle is perfectly strong and we'll see the same about Eastern Europe; that their sensible transition to market economy is successful and it will stay so.

Steve Weisman: Your description is a little contrarian for many Americans who feel that in light of the financial crisis, the problem has been lack of regulation, a lack of state supervision. And we do seem to be heading in that direction on Capitol Hill with the new regulations that are coming out. And most certainly in this crisis, more and more government intervention than Americans have seen in many years. Why haven't the Europeans shared in that disenchantment with free markets, in light of this crisis?

Anders Aslund: Well, if you look at the phenomenon, most of them didn't happen [in Europe]. Subprime is a truly American phenomenon because the Fed had the responsibility of regulating this and couldn't care less. Fannie Mae and Freddie Mac are a truly American phenomenon, which is massive state intervention without financing. To leave these huge mortgage companies 1.5 percent capital to be assets is totally irresponsible. And this was the Congress most of all, that did so. And then we have our colleague here, Simon Johnson, who talks about the financial oligarchy. Nobody in Europe can understand why Goldman Sachs has a hold on the Treasury Department. This doesn't seem normal as it should be. So it's more crony capitalism, that seems to be the problem, and an inappropriate mixture of state functions and private capitalism. So the United States looks more like state capitalism to Europeans than excess of capitalism.

Steve Weisman: That's a remarkable thing to say on this "20 years later" conversation. What about the countries outside the consensus that you've described? The ones where the state is still maintaining control—for example Russia but some of the other countries. What is the likelihood that they'll draw the lessons of the last 20 years that you've outlined?

Anders Aslund: I think generally, what we are seeing in Russia is that state capitalism is now in a dead end, Russia doesn't have the political forces to change it. But there is a very strong dissatisfaction with the situation. So it's still too early to say where Russia is going. Right now, it's simply in a suboptimal equilibrium. Ukraine is clearly pushing hard for more liberal market reforms. And I will say that is dominant in Eastern Europe today. We are seeing, in particular in the European Parliament elections in early June this year that the center-right parties won in most places. The outliers are Greece, where the Socialist won because of corruption scandals among the Conservatives. And Norway, where the left-wing coalition actually was reelected, but with a very small margin, and has always been financially pretty well managed. And it is now the country that is actually growing this year.

Steve Weisman: Some years ago, our colleague John Williamson coined a phrase "Washington consensus" to describe what was being preached to the developing world in terms of free markets, liberalizing, and so forth. That term has not always been well understood as John likes to point out. But still, it was a powerful term. I wonder what the term should be for this new center-right consensus that's emerging in Europe. Is this the new paradigm?

Anders Aslund: I would only say that we're coming back to John's old Washington consensus as it was in 1990, after a lot of discussion about the post-Washington consensus around the Asian crisis. The IMF has scaled down all these conditions that they imposed upon the East Asians in 1997/1998. And they look upon reasonable budget balance and a sensible, realistic exchange rate and that reserves are sufficient.

So if anything, this new consensus that the IMF represents today is much more narrow than the one that John proposed in the early 1990s. But the post-Washington consensus that Stiglitz and others proposed 10 years later—that was massively overburdened and I think now largely forgotten. The problems in East Asia were not grown in capitalism; it was just a current account crisis. I think that the United States has considerably greater problems with crony capitalism than East Asia had 10 years ago.

Steve Weisman: And of course the irony is that in this revival of the original form of the Washington consensus; if it exists, it appears that you think Washington is no longer a part of it.

Anders Aslund: Indeed. No, you have a point, when you think of it. Indeed, we are seeing it now in Central and Eastern Europe. And to take one example, Hungary, which has been the outlier that has been very social democratic with a big budget deficit, massive social expenditures. Right now, Hungary is tightening up and coming closer to the sensible policies of Poland, Slovakia, and the Czech Republic.

Steve Weisman: Anders, thanks so much for walking us through your sense of these changing economic situations in Europe and in the United States. It was great. Thank you.

Anders Aslund: Thank you.

