Issue II, Spring 2002 www.hcs.harvard.edu/~focus $5.95

HARVARD FOCUS EUROPE

EUROPES

Dear Readers,

The introduction of the euro on January 1, 2002, marked another step of increasing European integration. The EU's apparent importance in day-to-day lives of European countries has increased visibly when euro notes and coins appeared in the pockets of their citizens, and the EU's actual powers have also been receiving more and more attention. In the context of growing integration the question of identity comes to the fore sharper than ever. Is a resident of Rome a European? An Italian? A Roman? This issue of Harvard FOCUS Europe attempts to bring together several viewpoints that elucidate the question of different levels of identity.

We open our issue with the article by Linda McAvan, a Member of the European Parliament, who explores the effect of the euro on European's perception of the EU and their place in it, with a particular emphasis on Great Britain. Providing a philosophical context for the discussion, Christine Teylan explores the development of the idea of selfhood. Bodjar Manov, a film critic and a professor at the National Theater and Film Academy in Bulgaria, writes about the issues of national identity in the context of European film industry and its attempts to penetrate the American market.

We then zoom in on specific countries, with the article by Ionut Lazar on regionalism in Italy, an interview with Jugoslavian Ambassador to the United States Dejan Sahovic, and a report on Michel Rocard's visit to the Minda de Gunzburg Center for European Studies at Harvard. The issue also features an interview with Janos Kornai on the progress and results of economic transition in Eastern Europe.

In this issue, Harvard FOCUS Europe also begins a regular section on the Center for European Studies. We start with the interview with the Center's new director Peter Hall and a brief overview of its regular seminars and study groups. In future, we hope to report on the most interesting events, visiting faculty, and upcoming conferences.

HFE would like to thank the Center for European Studies for its generous support, geniune interest and invaluable intellectual input into our magazine.

We hope you enjoy this issue of Harvard FOCUS Europe, and, as usual, welcome your comments and suggestions for improvement.

Sincerely,

Diana Kudayarova
Editor-in-Chief

HARVARD FOCUS EUROPE

Volume III, Number 2 * Spring 2002

Focus European Identity

At the CES

Harvard FOCUS Europe welcomes commentary, questions, inquiries, and contributions. All letters should be addressed to:
Octavian Timaru
Harvard FOCUS Europe
c/o Harvard College
Cambridge, MA 02138, USA

For subscription service and inquiries, please contact:

Business Manager, Eugene Soltes
at the same address

Or e-mail us at focus@hcs.harvard.edu
Tel: 617-493-3195, Fax: 208-575-6048

Focus Eastern Europe

Features

Our mission

Harvard FOCUS Europe is an undergraduate student organization dedicated to promoting interest and fostering awareness of the rich and highly diverse political, cultural, and historical environment throughout Europe.

World Wide Web

Harvard FOCUS Europe is available on the Internet at http://www.hcs.harvard.edu/~focus

Interview with János Kornai

conducted by Andras Tilcsik

János Kornai is certainly one of the founding fathers of transition economics. There is hardly any book on transition economics that does not refer to his significant contributions to this field of economics.

Kornai is Allie S. Freed Professor of Economics at Harvard University. He is also Permanent Fellow of Collegium Budapest of the Institute of Advanced Study, and Research Professor at the Institute of Economics of the Hungarian Academy of Sciences. He has served on the Scientific Advisory Council of the European Bank for Reconstruction and Development, was vice chairperson of the United Nations Committee for Development Planning and has been president of the Hungarian Social Science Association, the European Economic Association and the Econometric Society.

He has been a visiting professor at the London School of Economics; Stanford, Yale, Princeton, and Stockholm Universities; and Fellow at the Princeton Institute for Advanced Study. An officer of the Ordre National de la Légion d'Honneur, he has received a number of honorary doctorates and awards. The author of more than 10 books and 80 papers, many of which were published in top journals, Kornai has been extremely influential in the field of socialist economies and in the new study of transition economics.

His well-known book A Passionate Pamphlet in the Cause of Hungarian Economic Transition, published in 1989, was the first book in the international economics literature to present comprehensive suggestions for the post-socialist transition. The Pamphlet was translated into 17 languages. The English edition appeared a year later, with the title The Road to a Free Economy. Shifting from a Socialist System: The Example of Hungary.

Harvard FOCUS Europe: Alongside with political change, the dominant position of private property plays a crucial role in your theoretical approach to transition from socialism to capitalism. In your judgement, how successful has the privatization of ownership been in Hungary?

J.K.: To be able to give a complete answer to this question, we need to use a very wide definition of privatization. We cannot only talk about the privatization of nationalized companies. Even if we just focus on physical assets and exclude intellectual properties, we need to include all kinds of physical assets in our definition, for example the assets of social security and health care institutions. It is important to point this out right in the beginning, because the mainstream of public thinking had a propensity to equate privatization with the transfer of state-owned companies into private ownership.

Hungary has gone quite far in the privatization of a large segment known as the corporate sector. Most of this sector and most of the state-owned real estates have been privatized. This part of the process can be considered completed, regardless of how well privatization has been carried out. In this sense, one of the basic foundations of a market economy based on private property has been laid.

The part of the process that was left incomplete has not yet been finished in many other capitalist countries either, so this is not a sufficient reason to consider Hungary as a non-capitalist country. There are many capitalist countries where, for example, quite significant portions of the assets of health care, education, or the railway system are in state ownership. Indeed, this part of the process is not a transitional problem. Given the current proportion of the private sector to the public sector, the Hungarian economy can be classified as capitalist. The question to be answered is which of the assets that are still state-owned should be privatized.

An important aspect of transition is the question whether the transfer of state-owned assets to private proprietors is always constantly going in the same direction. Experience shows that the process might come to a temporary halt, and can even become reversible in some cases. We need to be mindful of this problem when we look the achievements of privatization.

In industry and mining, privatization has achieved a desirable level. There were no instances in which the process became reversed. Housing privatization has gone quite far, too. Agriculture, on the other hand, is a much more problematic area. There are some signs of re-nationalization, for example the National Estate Fund, consisting of the presently state-owned properties and those to become state-owned through land purchases. Although this land fund is supposed to sell state-owned arable lands to private proprietors in the future, this process might come to a halt, causing nationalized and re-nationalized lands to get stuck in state ownership. This would be a very negative phenomenon. I believe that the role of the state as owner of agricultural assets is completely unnecessary. The state should not have more land than a few farms for educational purposes, for example, in case of a state-owned agricultural university.

As for transportation, the presence of the state as an owner is still much stronger than it should be. I do not think the privatization of the Hungarian Railway Company is on the agenda now, although some parts of it may be contracted out to private contractors. A form of re-nationalization took place in the area of air transportation. The privatization of public bus transportation has not gone far yet. Also, private capital, and not government expenditure, should be used to build new highways. The role of state ownership in this field is still too significant. Generally, in transportation, the presence of the state as an owner is unwarranted. In most cases, the state should only play the role of the controller, rather than that of the owner.

The privatization of education has not made significant advances. This is particularly true in the case of higher education. Again, this is not something unique. The strong role of state in higher education is not unusual in other European countries, either. But we can see the fantastically good effects the competition of private and state universities has in the United States, and how important a role private universities play in this competition. There is private higher education in Hungary, but it only plays a very marginal role. This structure reduces academic freedom and increases the dependence of institutions on the government. I think a healthy privatization process, and not a radical privatization campaign, would be desirable in this case.

In health care, the results are somewhat better. Privatization was mostly completed at least in the case of general practitioners. But privatization has not advanced as much as it should have, although the state, particularly local governments, should have a role in health care. I think it would be both harmful and morally unacceptable, if "privatization" took the form of giving away state-owned assets to some grasping interest groups free of charge, as a "national gift." Unfortunately, I must say that the danger of such a give-away is present. To avoid this, an appropriate legal framework and effective execution of laws are needed. The only reasonable technique of transferring state-owned assets into private ownership is sale. In this sense, the warnings of my book, The Road to a Free Company, remain very topical. The Road took a stand against free giveaways and recommended sale as the main technique of privatization, when many contributors to the international literature advocated some forms of a giveaway, especially voucher schemes.

The problematic areas are transportation, education, health care, and agriculture. The presence of private property should be much stronger in these cases. Despite this, Hungary is still one of the most successful post-socialist countries in terms of privatization. Of course, this does not mean that there is no room for improvement, and that privatization could not have been more successful. But Hungary definitely deserves credit for the fact that its private sector is now predominantly made up by what we call a "new private sector," that is, newly created companies rather than former state enterprises. In this sense, Hungary differs, and does so to its advantage, from the countries that, for a long time, concentrated almost exclusively on the nationalization of state-owned companies - such as the Czech Republic or Russia. The Hungarian privatization is a very positive example of an organic, bottom-up development of the private sector. Such a development, based on opening opportunities for new enterprises, should play a very important role in the future, too.

HFE: The recommendation of the Road about the strategy of organic, bottom-up growth of the private sector was a minority opinion in the international economics literature. It is clear that Hungary generally followed the path you had advocated, and that economic policies in Poland remained close to the strategy of organic development, too. The achievements of privatization in these countries proved you right. The Czech Republic and Russia, however, went along a different road and followed the strategy of accelerated privatization, which aimed at the rapid elimination of state ownership by some form of a giveaway. Curiously enough, some advocates of this strategy paid lip-service to Hayekian ideas based on the belief in the spontaneity of capitalism. What do you think explains this sympathy with the strategy of accelerated growth of the private sector?

J.K.: It is hard to generalize. The possibility of rapid change appealed to many of those in favor of this strategy. Clearly, this path is much faster than the "evolutionary" one that I supported in the Road. Another factor is a more theoretical consideration, based on the ideas of Ronald Coase. According to Coase, regardless of how inefficient the initial allocation of legal entitlements might be, an efficient allocation will ultimately appear through re-negotiations. One does not need to be an economist to see why this is most likely to be true. It is fairly easy to understand even intuitively that an inefficient allocation will not remain forever. Assume that a very gifted entrepreneur leaves his company to his son, who lacks any kind of talent. Sooner or later, this inherited wealth will end up in the hands of someone who is able to manage it more efficiently. This is a result of the functioning of the market. If the son is good at managing the company, he will be able keep it; if he is not, he will lose it. But there are two problems with implementing policies based on this theory.

One is that it takes time, perhaps quite a lot of time, until all inefficiencies are corrected and an efficient allocation appears. During this time, the country has to suffer from the inefficiencies. And this correction period can become very long and painful, if the allocation is inefficient in a whole economy. This is what happened in, for example, the Russian case.

The other problem arises if those interest groups who received property rights through the inefficient allocation are powerful enough to block re-negotiations. In this case, the correction process may stop. Just like in the case of privatization, and indeed in the case of transition as a whole, processes are not moving in the same direction continuously: they may come to a halt, or even reverse sometimes. Therefore, inefficiencies may not be corrected automatically. In fact, Coase himself gave a warning of this danger - but not much attention was paid to this additional qualification of his theory.

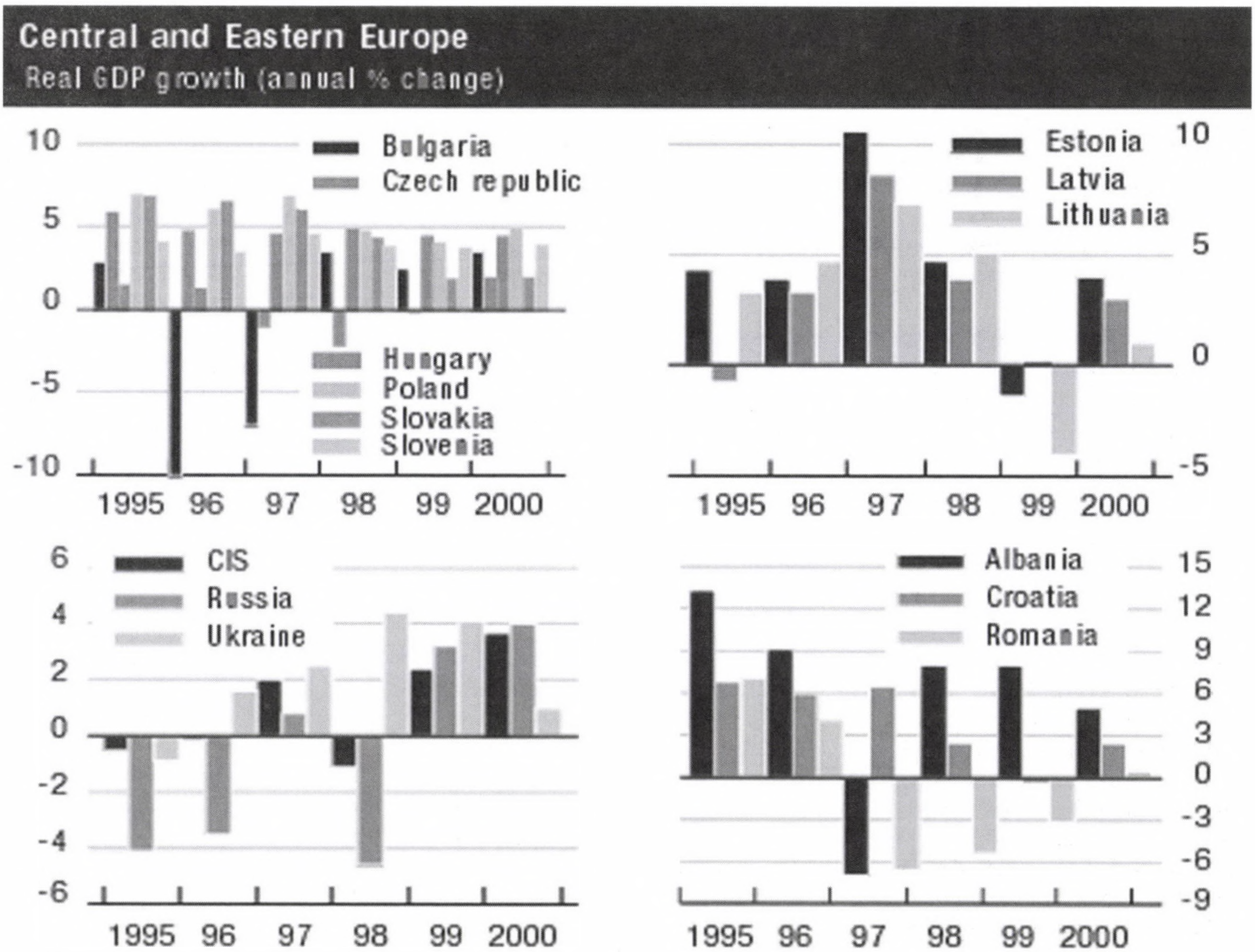
HFE: A very common question is when

the process of transition from socialism to capitalism is over. Economists use many different criteria to assess whether post-socialist transition has been completed in a country. A few years ago, you and five of your fellow economics scholars were asked this question after a series of lectures at Western Michigan University. Each of you gave a different answer and mentioned different criteria ranging from the admission to the European Union (in case of Central and Eastern European countries) to a well-functioning free market and various institutional reforms. Your definition was the most precise one: transition is over when three - and only three - criteria are fulfilled: when the communist party no longer has monopoly power, when the dominant part of the means of production is privately owned, and when the market is the dominant coordinator of economic activities. Why are there so many definitions, so many criteria that are used to asses whether transition is over? Is it actually such an important question, or is it more of a purely academic problem?

J.K.: I believe that those who seriously want to deal with this problem need to base their criteria on precise definitions. Otherwise, it would be impossible to give a well-justified answer to the question. It must be made clear what the characteristics of a socialist system and what the characteristics of a capitalist system are. Once we have these characteristics listed and carefully defined, the answer to the question becomes evident, since we can then easily assess whether a country is still socialist or has become capitalist according to our criteria. Depending on their yardstick, economists will arrive at different conclusions. For example, those whose criteria are mainly based on changes in the political realm will draw a different conclusion than those who view the process of transformation primarily in terms of coordination mechanisms and property relations.

The question when transition is over is a really important one. Clearly, this is in no case a purely academic question. Although, in my view, it is a very important theoretical question, it is not only that. The different answers given to this question do not only result from different theoretical considerations; they are also reflections of different political values and agendas.

HFE: While Poland and the Czech Republic took bold and drastic steps towards macroeconomic stabilization in the beginning of the process of transition, Hungary clearly failed to do so. The Balzerowicz program of 1990 in



Source: EBRD (forecasts for 2000)

Poland and the reforms by Vaclav Klaus's government in 1991 in the Czech Republic did not postpone measures of adjustment to their macroeconomic policies. Hungary, on the other hand, waited until 1995, when the country was already on the verge of a financial collapse. What explains this postponement of adjustment in the Hungarian case?

J.K.: Before I answer, I would like to make it clear that it would have been better to make this adjustment as soon as possible than to wait and keep postponing it. While we can pay tribute to Hungary for the way privatization was carried out, we can in no case praise the Hungarian policies targeting macroeconomic stabilization in the early years of the last decade.

Postponing painful but necessary decisions is, of course, not unique to Hungary. It happened and is happening frequently in many countries. It is enough to consider the case of Argentina. The current tragic situation is obviously not a result of the last short-term decisions or the lack of them. It is the manifestation of problems that should have been dealt with earlier. Similarly, the Russian financial crisis in 1998 did not just break out suddenly: it was the consequence of troubles that had already been there for long.

Governments have a propensity to postpone painful decisions until they are facing the danger of a catastrophe. It is not impossible to understand why this is the case. Politicians may hope that a potential crisis will be avoided even without painful intervention. They may be overly optimistic and believe those of their advisors whose forecasts are less alarming. Also, they might be afraid of preventive actions, just like those who avoid the dentist until tooth extraction becomes inevitable. Those who behave this way do so because they do not like to make decisions, they do not want to make tough choices. As a result, they have to act only when they do not have choices any longer.

Quite frequently, as a result of such behavior, the action is not taken by those who kept postponing long-needed decisions but by their successors in power. Just consider the example of Argentina again. The president who accepted the burden of taking action was someone innocent of postponing preventive measures. It is often necessary to change government for action to be taken to achieve macroeconomic stability. In Indonesia, for example, the whole political leadership had to leave the scene in order for reforms to be implemented.

In Hungary, too, the government that took the necessary actions was not the government that had postponed the decision about those actions. The first democratic government, under Jozsef Antal and Peter Boros, failed to implement measures of adjustment to the country's macroeconomic policies. Adjustment measures were taken by the government of Gyula Horn, only after the whole first four-year parliamentary cycle and eight months of the second had passed. In fact, Horn's government did not wait until the last minute: they acted in the second last minute. Hungary, unlike Argentina, did not need to declare itself bankrupt. Clearly, action was taken after the optimal moment had passed, but at least it was not postponed until a financial catastrophe occurred.

Generally, the more serious a situation seems, the easier it is to make unpopular actions accepted. It is easier to communicate painful policies in an acute crisis than in a situation of a catastrophe forecasted by the government but not yet experienced by the people. This is why wise, preventive actions are so rare. Usually, it takes a disaster or at least the wind of a disaster to make decision-makers implement painful macroeconomic reforms.

HFE: Is economic reform then always largely dependent on the political environment?

J.K.: Yes, absolutely. We should not have illusions and expect such decisions to be taken in a purely rational, economic context.

HFE: Was the propensity of governments to postpone painful and potentially unpopular actions a general characteristic of the transition in Central Eastern Europe?

J.K.: Yes, it was quite common that it took "catastrophe signals" before governments decided to take action. Such "catastrophe signals" induce action in many areas of life, not just in economic activities. An evident example would be the measures to improve airport security, which were taken only after the terror attacks on September 11, only after "catastrophe signals" occurred.

HFE: So does this behavior - which is common when it comes to implementing painful economic reform - have its origins in human nature itself?

J.K.: Yes. Many people choose to abandon their unhealthy lifestyle only after they have their first heart attack. It is part of human nature to have a tendency for postponing painful decisions. It is not too wise; it is in a sense irrational, but psychologically understandable.

HFE: The post-socialist transition in Central Eastern Europe took place in a globalizing environment. How did this affect the transitional experience of CEE countries? In what ways would their experience have been different without this unique international context?

J.K.: We can only use contra factual speculations. In my view, the presence of active and mobile international capital contributed to the transition extremely positively and constructively. This type of capital greatly accelerated the transition from the rigid, inefficient socialist system to capitalism. If the CEE countries had been confined to using the capital that they themselves created, transition would have been much slower.

The primary example of the effect of globalization on transition is Hungary. The level of foreign direct investment was the highest here out of all CEE countries. This factor was definitely one the engines of the economic successes in Hungary. If Hungary had been able to rely only on its nationally accumulated capital, transition would have taken much more time, and the lag behind Western European countries would be much bigger now. Global capital seeks international investment opportunities and Hungary was very attractive in this sense. In general, CEE countries are quite attractive to international capital, since they offer a combination of relatively good intellectual potential and relatively low wages. But the effects of a globalizing international environment largely depend on how open a country's internal forces are to globalization. The more open a country is, the stronger these effects are.

HFE: Does this mean that Hungary was more open to globalization than other CEE countries in general?

J.K.: Yes, Hungary was relatively more open to globalization and more attractive to international capital than the other countries in the region. But this does not mean that Hungary was equally open in all areas. Agriculture, for example, was not open to the effects of globalization at all. And the impacts of this isolation show up in the extremely problematic condition of Hungary's agriculture today.

It must also be noted that for a country to be able to exploit the favorable effects of globalization, it is not enough to be attractive because of material and physical conditions. Government policies, the legal framework and the mentality and attitudes of the population are equally important. Xenophobia and discrimination against foreigners, for example, make it much harder for a country to reap the benefits of globalization. It should not be forgotten either that attracting foreign capital is much more of an endless war than a single battle. It is hard to gain advantages, but it is really easy to lose them. Advantages should be both enjoyed and protected, because they are not given forever. Therefore, government policies and the attitudes of the population are crucially important determinants of the beneficial effects of globalization in a country. If the government or the population of a country develops xenophobic attitudes, it becomes much more difficult to exploit the favorable impacts of globalization.

I would like to stress, however, that my opinion is based on the belief that it is desirable for Hungary to join the international circulation of technological information and scientific knowledge and thus accelerate its economic growth. By contrast, some people believe that the most important pursuit should be the protection of the intactness of national culture from foreign influences. I would not like to completely ignore this view. Clearly, globalization brought the inflow of both cultural values and cultural filth. Personally, I am very particular about my taste in art, music and literature; I am far from being enthusiastic about cheap soap operas and popular music with no lasting value, but I still do not think that national cultures should be protected by isolation. Instead, education and support for the values of national culture should be the tools to avoid these negative side effects. I believe that the benefits of globalization outweigh its harmful side effects. While I would like to mitigate the negative effects, I am very strongly against isolationism. In fact, as a result of openness to globalization, transition was not only faster, but perhaps also more interesting, exciting and colorful, even culturally.

HFE: So in this case, as in so many others in economics, we are facing a trade-off. And it seems that if we go with the alternative of openness, the negative effects can be reduced to some extent.

J.K.: Yes. This is a trade-off effect, and I believe that, on the whole, openness is more beneficial than isolationism.

HFE: I would not like to ask you when Hungary or other CEE countries are going to join the European Union, because...

J.K.: Well, I would have a short and simple answer to that question: I do not know.

HFE: I guessed that you would give this answer. This is why I wanted to ask you about the integration of CEE countries in the long run, and not about a date when you think they are going to join the EU. When do you think CEE countries are going to fully integrate into the European Union? Or is it just impossible to make such a prediction, too?

J.K.: Integration has different degrees. Legal harmonization will have taken place by the time these countries accede to the EU - otherwise they would not be granted accession. This part of the process follows a pre-determined timetable. It is quite a different question when convergence in the countries' level of economic development will reach a point where, for example, a Romanian skilled worker earns the same amount of money as a Swiss or German skilled worker. I would say that this will take quite a long time.

Convergence works in both ways. The development of the poorer countries may accelerate, while the growth of the richer ones may slow down. Perhaps CEE countries will get closer to those that are now already in the EU, but it will take a long time to achieve full convergence. Clearly, the bigger the initial lag, the longer time it takes to catch up.

HFE: The example of East Germany is often cited in relation to the issue of convergence of post-socialist countries. During the years between the unification in 1990 and early 2001, massive financial transfers mounting up to more than 1800 billion Deutschmarks were pumped into the East German economy. Despite this, convergence is taking much longer than the Germans thought it would in the early days of unification. The title of a 1998 TIME article appropriately places East Germany "East of Eden." This seems to support your argument, because CEE countries clearly do not benefit from such enormous financial transfers.

J.K.: Exactly. Convergence is not hopeless though. But calculations that predict which year it is going to finish by using fixed growth rates do not work. Both theoretical models and historical experience show that the rate of growth decreases as a country grows richer.

There is also another issue here: the integration in terms of social, political and cultural norms. I hope this will happen earlier than convergence in economic indicators. But this process is not an automatic one. It is slower if there is any resistance against it. If there is resistance, it depends on its strength and forms how the speed of integration is affected. Therefore, government policies and the attitude of political parties play a crucial role in determining how soon this layer of integration is completed.

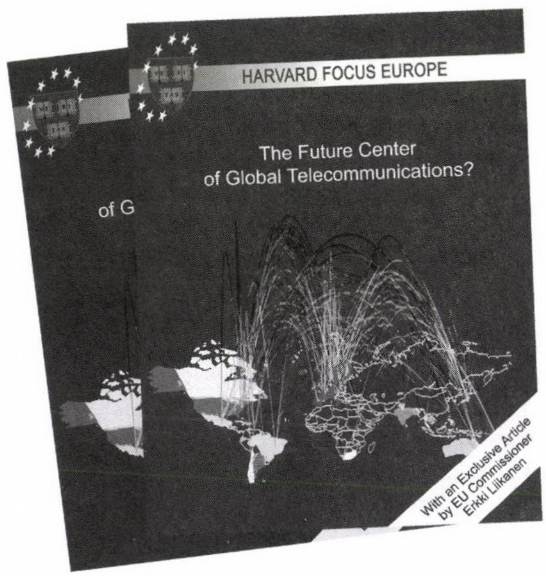
Interview conducted in Hungarian on February 8, 2002. Translation by Andras Tilcsik.

Harvard FOCUS Europe

We believe in looking at more than one side.

That is why in every issue of ***Harvard FOCUS Europe*** we try to bring you a broad range of perspectives on important European policies and developments:

- from academics and policy makers
- across the European political spectrum
- from within and outside Europe.



Because we believe that you can make up your own mind.

For further information or to subscribe, e-mail us at focus@hcs.harvard.ec or write to Harvard FOCUS Europe, c/o Harvard College, Cambridge, Massachusetts 02138, USA.

Individual subscriptions:
1 year - $15
2 years - $25
3 years - $40

Institutional subscriptions:
1 year - $30
2 years - $55
3 years - $80

For overseas subscriptions add $20 a year for postage.