

Encouraging Entrepreneurship in Eastern Europe

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Table of Contents

Part I:

Is the Post-Communist Transformation on Track? by Andrzej Brzeski

Pessimism about Transition & The Puzzling West by Ljubo Sirc.....

Part II:

First Session:
Eastern Europe (Slovenia) compared to Africa, and to Germany in the 1940's.....

Moderator: Ljubo Sirc
Philip Booth and Rado Pezdir

Second Session:
Spontaneous Entrepreneurship and Apparatchik 'Entrepreneurship'.....

Moderator: Silvana Malle Contributor: Vladimir Benacek,

Third Session:
Entrepreneurship in the Light of Human Rights and Judiciary.....

Moderator: John Moore Contributor: Peter Jambrek

Fourth Session:
The Continuation of the Communist "Disturbance" and the new "Islamist" Threat.....

Moderator: Matej Kovac Contributor: Robert Reilly

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Is the Post Communist Transition on Track?

by
Andrzej Brzeski

In their paper, *1989–2004: 15 years of Transition* (presented at last year's CRCE Symposium in Bled), our Czech colleagues Vladimir Benacek and Alena Zemplinerova, seem to suggest the answer to the question is yes. "Notwithstanding enormous transaction costs," they conclude "clashes of the market system sector with hierarchical governance systems, and the protracted delays in concomitant reforms ...economy has shown its...viability during transition and, in the long run. Leads gradually the way to the improving prosperity in transition countries". Allowing for inevitable differences between countries, this may well turn out to be the case.

Still, at the present stage, there is much to be wary about. When Marxist–Leninist party states were collapsing, many of us had high hopes for Soviet Bloc capitalist transformation. The key ownership reform seemed simple: a speedy privatisation by any and all means. Vouchers, sales to foreign and domestic owners, including workers cooperatives, were all considered a part of the solution. Indeed, a distinguished American economist only half jokingly assured his audience, that even dropping shares at random from an aeroplane would do. We now know that he was wrong. Privatisation has proved the trickiest part of post-communist reforms. Problem-and-scandal ridden, it is still going on after a decade and a half. By comparison, the initially intimidating task of macro-stabilisation turned out to be more tractable.

The capital has been in short supply, both domestically and internationally, which has of course been an impediment to the development of private enterprise. But the root causes of the difficulties lie in the politics and sociology of post-communism. The ruling parties saw themselves forced formally to give up power, but their functionaries, including police, managed to hang on to positions of influence. Some survived in politics, others continued as managers of large nationalised firms, still others, on the strength of their connections, turned *biznesmeny*. With the legal system in flux, and the courts stacked with communist nominees, the uncertainties of going into legitimate business was likely to discourage many. Only the well-connected could count on succeeding. Nor, one would think, was the refusal to compensate original owners for property confiscated by communists helpful in rebuilding the moral foundations of capitalism. Altogether, the circumstances have hardly been conducive to entrepreneurship, which, as we know, is the key ingredient of economic progress.

What can outsiders do to encourage entrepreneurship in post-communist countries? Unfortunately, not very much. There is, of course, the possibility of providing more training opportunities, and increasing the availability of seed money. At best, the effects of such measures are marginal. More important, especially inasmuch as the European Union is concerned, is strict observance of the Hippocratic *primum non nocere*, especially in the member countries. Post-communist countries should be shielded from the excesses of Brussels' regulatory zeal. That is about all that could be usefully done.

In time, with generational change, the communist influence in the countries of Central and Eastern Europe, eventually, even in Russia, is bound to weaken. For better or worse, post-communism will be submerged by Europe. New challenges will no doubt arise, and some of the old ones will reappear. This, however, is another story.

Notes for the Colloquium

by Ljubo Sirc

Pessimism about Transition

Communism as an economic system has broken down both in its mass central planning and Yugoslav self-management forms.

Reasons: obvious lagging behind the very successful West European economy with standards lower than the 1940 level (in Yugoslav case about the same level).

Politically: communists remain organised underground and in the open by changing the names of their organisations and were thus welcomed with open arms by the Socialist and Liberal Internationals.

Aims of “disguised” communists: are most certainly not to restore the old, failed communist economic systems, but rather to stick to power by being re-elected, and by acquiring as much private property as possible. This is done during the privatisation process.

It is anyone's guess whether such power will be used for this purpose only or whether an attempt will be made to restart some kind of communist economic system. The latter may be deemed necessary to avoid accusations that the “former” communists are just enriching themselves.

Meanwhile the communists are causing confusion in the European Union. There are at least six communist

Commissioners. Nobody questions their legitimacy whereas Buttiglione was thrown out because he believes that homosexuality is sinful. This apparently is the reason to deny him a place in the Commission, whereas no one questions the antecedents of the communists whose parties practised mass murder and revolutionary deception not so long ago.

A while ago the European assemblies passed resolutions on the lustration of communists and restitution of property (for example, Parliamentary Assembly of the Council of Europe Resolution 1096). At present, anyone who warns against communist trickery is decried as a nuisance, and the same goes for victims of communism.

It is not just that privatisation of property into communist hands has strengthened their ability to hang on to power, or at least to retain much influence, it will not advance the countries in question economically. The communist private owners are not potential entrepreneurs but party bureaucrats.

This is a survey of questions on Eastern Europe which the Western media do not discuss. Why? They are not only of importance to Eastern and Europe: the Eastern disregard for the rule of law, private property and common decency will spread to the whole of the continent. Attention should also be paid to the damage done by the currently fashionable anti-Americanism.

The Puzzling West

In view of the pessimism expressed above, it is surprising that the West does not pay more attention to what is happening in the “new Europe” and is not more interested in advising it and assisting its advance. Little is also known of the economic conditions in the east and economic policies devised to improve those economic conditions that were caused by inept communist management.

The country worst hit by communism, as far as economic performance is concerned, is the Czech Republic which had competed with Austria and Germany before 1938. In 1997, its GDP per capita on the basis purchasing power parity was 68.1% of the European average, little more than half the figure for Austria. Others are far behind: Poland, for instance, clocked up just 44.1% of the European average and only one third of the Austrian result. All countries, with the exception of Slovenia, have lower GDP per capita and lower wages than before the Second World War. Slovenia is an exception because it was part of Yugoslavia and expelled from the communist camp by Stalin, and had to change from Stalinist central planning to self-management. This latter at least partially used goods markets which helped it to perform better. In addition, Yugoslavia was receiving considerable military and economic aid from the West. All in all, Slovenia's GDP per capita and wages were comparable to the pre-war level when it was catching up with Austria.

In fact, Slovenia had a GDP per capita twice the Yugoslav average, which was approximately equal to the figure for Serbia. The Yugoslav average moved from 30% of the Austrian level in the 1920s to 40% in the 1930s, which

translated for Slovenia was 60% to 80% (yet not PPP). At the beginning of the 1990s, Slovene wages PPP were less than half of Austrian wages and only slightly higher than before the war. At present Slovenia is catching up with Greece, which used to be on a level with Serbia, and this is also true for Portugal. According to the Eurostat figures (see *Delo*, 21 December 2005, p.15) Slovene GDP in 1997 was 70.9% of the European average and 57% of the Austrian result.

Looking at the progress of the “New Europe” countries, the best without doubt is Estonia, which between 1997 and 2006 advanced 20 percentage points from 38.3% of the European average to 53% amounting to a 50% improvement. Slovenia moved from 70.9% to 83.1%, i.e. 12.2 percentage points, or 17%, and: from 44.1% to 51.3%, i.e. 7.2 percentage points, or 1.4%. The percentages for improvement are not absolute figures, but figures indicating the relation in the improvement vis-à-vis Europe of 25.

The results are not encouraging for the countries at the bottom, so one would expect the West to consider what to do about it. The picture is somewhat different. According to *The Economist* of 12 November 2005, the downfall of the communist successor party in the Polish election brought in a new high-powered anti-corruption body to investigate what many Poles see as the festering mess left by botched privatisation and the crony-run state bureaucracy. The Adam Smith Centre in Warsaw published a similar assessment (*Delo*, 28 November 2005). This disaster has been presided over by Alexander Kwasniewski, seen as one of the champions of New Europe.

Despite this, Poland under his presidency ended in a mess. Furthermore, Kwasniewski vetoed an attempt by the *Sejm* – the Polish Parliament – to introduce even limited property restitution to original private entrepreneurs and their families. Thus, he prevented Poland from taking a course away from the communist morass.

In the same way as other communist leaders surviving transition, he wanted property to be acquired by his comrades so that the communists could still use property as a lever to power.

Restitution would have been a decisive contribution according to Mart Laar, twice prime minister of the successful transition country of Estonia. He writes¹ that countries, able to combine restitution of property and privatisation, achieved the most rapid breakthrough in ownership relations and were most successful in general. The Estonian results point us in this direction.

For similar reasons, there was strong communist opposition to restitution in Slovenia where there was no mention of a Jewish question. The Restitution Law, passed in 1990 and 1992, was sabotaged by communist judges and officials. It was substantially watered down in 1998 in opposition to the prohibition of ex-post-legislation in principle and under European Human Rights Law.

¹ Laar, Mart. *Little Country That Could*, CRCE, London 2002 p.263

This is, of course, not the road to economic prosperity but a shortcut to the aforementioned mess. Janez Sustersic, a leading economist in Slovenia, describes a similar situation:

All economically developed countries possess their own élites. Yet an essential difference between Slovenia and classical capitalist States is that these latter have developed generically and this is what we, in our country, do not understand. In the countries with a 200-year capitalist tradition, the economic élites issued from entrepreneurs who had accumulated capital step by step on the basis of their own entrepreneurial ideas, knowledge, risks and innovations. In our country, the capital élites have not developed in the market way, but mostly through the administrative process of distributive privatisation, speculation and a rent system. Whether our élite, holding capital acquired in this way, will be a success in business showing in the market, remains to be seen. (*MAG*, No.3, 2005, p.40.)

Even worse than entrepreneurs not being in the right places, is that these arrangements destroy the reliable working of the markets. Niall Ferguson writing in *The Sunday Telegraph* (2 October 2005) put it very clearly:

The result is that the allocation of funds for investment and credit is not done on the basis of meaningful competition and relevant information, but through personal connections that maximise returns to a powerful few, rather than general economic efficiency.

He was referring to China, but it describes exactly the communist logic when they are trying to get away from “communism”.

Western politicians are aware of everything that has been said, or certainly should be. Private enterprise is supposedly part of the Western way of way of life, and is certainly how Western countries gained their economic prosperity. Yet, for the moment, they seem only to wish to befriend the former communists by favouring them even at the expense of their victims — who were friends of the West.

West Germany, so successful in turning the corner after Nazism, had nothing better to do after 1989 than to stick to dubious policies and to gang up with Chirac and Putin. West Germany's difficulties with the east of the country should have taught it the importance of applying sensible policies (which they knew well in the 1940s and 1950s), to solve problems caused by dictatorship and planning. Even more surprising is that no one in the West seems to have any advice to the countries in transition on how to resolve their problems. It is true that in 1996 the Parliamentary Assembly of the Council of Europe adopted Resolution 1096 which, amongst other measures, advised:

that property, including that of the churches, which was illegally or unjustly seized by the State nationalised, confiscated or otherwise expropriated during the reign of communist totalitarian systems in principle be restituted to its original owners in integrum.

There were other similar pronouncements, but they were aimed at dismantling the communist totalitarian system rather than reintroducing smoothly operating markets, based on entrepreneurship. In consequence, it was not long before it was said that “advice” such as that given by the Parliamentary Assembly was not binding. Then “useful idiots” or

straightforward crypto-communists were able to help communist leaders to reappear as exemplary democrats. A document, *Response 97*, issued by several Slovene intellectuals, complained that on World Human Rights Day, 10 December 1997, the Slovene State Assembly had rejected, by two votes, a resolution on the communist totalitarian regime's unlawful activity in Slovenia.

As far as economics was concerned the communist successor parties, renamed the Liberal Democratic Party and the United list of Social Democrats, succeeded in eviscerating the then laws on restitution of "expropriated property of 20,000 families" (in a country of 2 million inhabitants). The document concludes:

Instead, property has been transferred to the personal ownership of the former communist ruling class. These same people — with the aid of the media — continue to maintain overall control over public life.

There was no reaction from the West. Initially, there was a condition that former communist countries would have to return confiscated and nationalised property before being admitted to the EU. Somehow this has been forgotten, with future protection of property promised.

Although the EU left-wingers did not expect difficulties after abandoning restitution clauses, they promptly appeared in the form of bad performance by enterprises. The discussion of a lack of entrepreneurship is rife, at least in Slovenia. Janez Sustersic has been mentioned. *MAG* of 16 November 2005, has two articles on the subject, one by the editor Stanislav Kovac and another by Professor Ales Vahcic. The latter is

most explicit: “I consider a false entrepreneurial élite all those who acquired property through rent or speculation.”

What now? One would hope for an answer from professional economists. After all, Friedrich von Hayek has described how functioning economies descend into socialism and what the consequences are. He warned that the reconnecting of the loose ends, of what he considered a spontaneous process, would be difficult. But there is no other way out than to try and restore private property — we know that it works, and is seen to be doing so in the West and parts of Asia.

Of course, the passage of time has eliminated the original entrepreneurs and quite a few were murdered by the communists. All that remains is inheritance which is not the same, but neither are family firms unknown in the world, and inheritance has always been considered legitimate. We know that many consider inheritance unjust, but many also consider private property immoral. However, both are practical solutions which work better than any other in the interest of all. Inheritance guarantees continuity of endeavour, so much so that even countries with inheritance tax often exempt family firms. Furthermore, one certainly wants the communists to lose control of the economy and society — they have done excessive damage for intelligent and cautious citizens to trust them again. They may no longer want to reintroduce socialism, but they stick to its negative formula, its old banner of anti-capitalism² This revised attitude hardly qualifies them to run transition.

² Conquest, Robert, *The Dragons of Expectation*, Duckworth, London, 2005, p.13

More Western participation in the debate would be eminently desirable — on how to recover private initiative and entrepreneurship. Governments, political parties, and universities and most especially think tanks, in particular those linked to Hayek and his followers, should all be involved. For some reason, discussion of the need for, and working of, private enterprise has been badly neglected.

Presumably, this neglect is due to the ubiquity of private enterprise in the West. Everyone takes it for granted and is not conscious of its great contribution to the economic development in the last two to three hundred years. This excessive familiarity³ may explain why some well-known economists, such as Jeffrey Sachs, considered it their duty to go to Eastern Europe at the beginning of transition and solemnly advise that it would be a mistake to return property to those deprived of it by the communists. Since abolition of private property was the central idea of communism and communism failed abysmally, one would have thought that the reformers would plan to mobilise private property and private entrepreneurs. Instead, we had a lot of talk about macroeconomics at the expense of a micro discussion of economic units.

Sachs himself continued to neglect the decisive role of private initiative in launching and maintaining economic development, when it transpired that most of Africa remained poor and often on the brink of starvation. Socialism, particularly in the Non-Aligned Movement, dissuaded them

³ Sachs, Jeffrey, *The End of Poverty*, Penguin, London, 2005

from cultivating the beginnings of free enterprise. In a way, the problems of Eastern Europe and Africa are the same except that Eastern Europe did not fall back under communism to the same level of poverty as Africa.

Another consequence of the West's reluctance to promote the decisive influence of private enterprise, is that the opponents of communism do not quite know what to do when elected to government. This misunderstanding and uncertainty of direction goes so far that Vaclav Havel, instead of rejoicing over the demise of communists, accuses the new non-communist governments in Eastern Europe of dangerous "populism". (*Delo*, 7 November 2005). Not that former President Havel is a very good judge. In 2001 he took to Milan Kucan, then Slovene President, and seriously discussed moral problems with him. (*Delo*, 29 May 2001). To discuss morality with Kucan is like discussing sobriety with a drunk. After all Kucan was the last secretary general of the Slovene Communist Party. This party turned the liberation war into a class war and massacred hundreds of thousands of co-nationals as an introduction to totalitarianism. Kucan has never repented and still claims to have learnt a lot from his sponsor, Ribicic, a notorious member of the murderous communist political police.⁴

Even economic success could not cleanse the Slovene and other communists of the crimes, but there is no question of

⁴ Sirc, Ljubo, *Portrait of a Political Policeman*, CRCE Briefing, London, 2003

economic success. In Eastern Europe, the communist regimes reduced the standard of living to below pre-1939 levels.

These data bear repetition because it has to be realised that the communists ruined the economies of the countries they ran, so that more tinkering cannot change much. The former communist countries need radical reforms, including a return to predominant private property. It is a pity that *The Economist* when reporting (15 October 2005) that the new Slovene Prime Minister intends to adopt Estonian transition policies, did not mention that Mart Laar includes restitution of property amongst the most important measures during transition back to capitalism and prosperity.

First Session

Eastern Europe (Slovenia) compared to present-day Africa and Germany in the 1940s

Ljubo Sirc: Originally, I had asked Andrzej Brzeski to take the chair of the first session as this conference is to celebrate his 80th birthday. He thought it would be awkward if he celebrated his 80th birthday chairing this session, which is why I am here. But he also refused to chair the session because he says he cannot hear well. I am not quite certain that my hearing is any better than his, but I have simply taken the chance and I hope it will work. If not, we shall simply have a discussion at cross-purposes, which these days happens quite often so it will not matter all that much.

Maybe you will allow me to say a few words since I concocted this strange combination of subjects, and I shall tell you why. It is partly because Eastern Europe and Africa find themselves in a similar situation in spite of the fact that they are at different levels of development. Both Eastern Europe and Africa have problems, Eastern Europe with starting new developments and Africa with starting any development at all. In the end we added Germany because Germany, after all the upheaval of Nazism and the Second World War, had a very smooth transition in the 1940s and 50s. I believe one of the questions which really arises is why did not only Germany but also Italy and France see a minor economic miracle?

So three countries, two of them because of previous regimes and one because of occupation, were in a very different situation but we started development without any particular problems. Why is that? This is a fundamental question and I have a partial answer to the question of Africa. You may call me quarrelsome but I shall bring our former leader Tito into the picture, because he is partly responsible for the situation in Africa. Even after having been thrown out of the Communist Bloc Tito had nothing better to do but to organise this non-aligned movement, the purpose of which (and do not forget that Castro was a member, which says quite a lot about its nature) was to spread the socialist gospel where the Soviet Union and its satellites had not succeeded. Fortunately this did not work, and we can be only too glad about the developments in South-East Asia, where Nehru, who was one of the initiators of the non-aligned movement, had much influence, and the countries there, which started at the right end, developed very well. But I want to stress that there was this influence in Africa, and this must have contributed to the present situation.

I will introduce our first speaker, Professor Philip Booth. I am particularly glad to mention that he is connected with the Institute of Economic Affairs, an institution we all know very well, and Lord Harris, who is the founder of the Institute, is our chairman of trustees. I myself worked at the IEA for a while and remain connected with it, so welcome Professor Booth.

Good Governance

by Philip Booth

In the recent discussions and debates surrounding the G8 summit “good governance” was frequently mentioned as a pre-requisite for development. What do we mean when we talk about good governance? What are its effects? And how do African and Central and Eastern European post communist economies compare?

What do we mean by good governance?

When politicians talk about good governance, they invariably talk about the establishment of democracies. Democracy may be an ingredient of good governance but it is neither a necessary nor sufficient condition. If, by democracy, we simply mean the election of our law makers by the people, then it is true that the people may be an effective constraint to prevent the abuse of power by rulers, and thus democracy may be useful in promoting good governance. The greatest value of democracy lies, perhaps, in its ability to reject a government that does not observe the basic norms that we will talk about a bit later. The ability to remove, rather than the ability to impose, is democracy’s greatest virtue.

There is a danger though that any action comes to be seen as legitimate because it is undertaken by a democratic government. The greater the apparent legitimacy of a government the more likely it may be to abuse its power. We do not have to look very far to find examples of this problem. Many ex-communist leaders were re-elected in ex-Soviet states and have ruled in a way that is not compatible with

basic human dignity and freedom. The same is true in Africa, of course. Though we suspect that Robert Mugabe rigs elections, it is probably the case that he would be elected even if he did not. Clearly democracy can be used in a “positive” sense (and here I do *not* use the word “positive” to mean “good”) to create structures that centrally plan an economy and that give governments unreasonable power that can be used to undermine human freedoms and dignity. In my view that is not the purpose of democracy.

Democracy therefore should not be our ultimate aim but it is one of the methods that is probably helpful, in most circumstances, in achieving our aim of good governance, the characteristics of which I will spell out more clearly in a moment.

So, if democracy is not what we mean by good governance, what do we mean? This is not a theology seminar, but it is worth quoting from Catholic social teaching, specifically from *Centesimus Annus* by John Paul II:

The activity of a market economy, cannot be conducted in an institutional, juridical or political vacuum. On the contrary, it presupposes sure guarantees of individual freedom and private property, as well as a stable currency and efficient public services. Hence the principal task of the state is to guarantee this security, so that those who work and produce can enjoy the fruits of their labours and thus feel encouraged to work efficiently and honestly...

The basic problem of most underdeveloped countries is that governments are not performing their fundamental functions of protecting private property, protecting individual freedom and enforcing contracts.

The characteristics of good governance include: peace, the rule of law, the authority of law, the absence of corruption, independent judicial processes, the enforcement of contracts, basic free markets or freedom to exchange goods and services, and the enforcement of property rights. These issues should be the basic starting point for any constructive discussion of development. Every other policy in the economist's toolbox is secondary to having these basic requirements of good governance in place.

I am going to take these characteristics of good governance one at a time, explain what they are, how they manifest themselves and their impact on society.

The Characteristics of Good Governance Explained

The rule of law and the authority of law

When we talk about the authority of law, we simply mean that laws are obeyed and enforced. However, this is not good enough by itself if the laws are unjust or the methods of enforcing them are unjust. Thus what we call the "rule of law" is as important as the "authority of law". By the rule of law, we mean broadly that:

- Those who make the law are subject to the same laws as other citizens.
- There is a separation between those who make the law (the government), those who enforce the law (the police) and those who administer the law (the judiciary).

- The law itself is subject to constraints. These constraints may be in the form of the common law and unwritten constitutions (like in the UK) or written constitutions (like in the US). Those constraints should define the areas where the law cannot intervene — for example it should not be able to intervene to expropriate justly acquired property.

The definition and enforcement of property rights

The lack of definition and enforcement of property rights is perhaps the key economic problem in underdeveloped countries. In the West, we take it for granted that property rights are defined and enforced. Occasionally, we get an exception to this general rule and it causes much angst. But, a fundamental problem in most underdeveloped countries is that property rights are informal; they are not properly defined. People who believe they own property cannot prove it. They might be able to carry on living where they live or farming where they farm for a very long period of time. They might already have done so for generations. But, one day, the action of a local council, government or powerful business man might simply remove them from their property or land. And there will be no redress in the courts. This means that they cannot use their property or land as collateral to start a business; they cannot obtain credit against their house to finance education. It may be impossible to find land for a home or business which has secure property rights because such land is expensive because there is so little of it.

This problem does not just pervade African countries but is rampant throughout all parts of the world that are poor. In

Delhi and Bombay, for example, these problems lead to land values being ten times as high relative to income as they are in Tokyo.

Recognition of contracts, corruption

The next problem is the lack of recognition of contracts, combined with corruption. The success of the British capitalist economy in the nineteenth century relied in large part on the security of contracts. When contracts were made they were adhered to. On the odd occasion they were not adhered to, they were enforced by the court or by another body (such as a stock exchange). This was true even of verbal contracts, hence the UK stock exchange motto “my word is my bond”. On the whole, in the West, we can broadly trust people we do business with and we can trust courts to enforce contracts when they are broken. Imagine, though, a small businessman. He makes a contract with a large steel producer and provides £50,000 of equipment for pressing steel. This is equal to 200% of a year’s profits for the small businessman and, say, 10% of annual turnover. The equipment is delivered, an invoice follows and is never paid. The small firm takes the large firm to court and the large firm bribes the judge. The judge finds in favour of the large firm.

These problems are pervasive in developing countries. When such patterns of behaviour develop business grinds to a halt, except where it is conducted on an informal level, between individuals. Small businesses, in particular, suffer at the expense of the rich and powerful — and the rich and powerful are often connected with government.

Related to both these problems of property rights not being recognised and contracts not being enforced is the problem that businesses often cannot get incorporation recognised, or indeed, it may be illegal for a business to operate without very strict conditions being fulfilled. In such circumstances, either businesses cease to operate at all or they operate in informal settings which mean that none of their agreements with customers or suppliers are enforceable.

Thus when we talk about good governance in the economic sphere, we mean the definition and enforcement of property rights and business incorporation, the legal recognition and enforcement of contracts and the absence of corruption. We also mean, though this is more obvious and needs less explanation, the absence of intrusive regulation that impedes business and prevents individuals from going into business. For these economic aspects of good governance to exist we need political structures to be established under the rule of law and for the authority of law to be upheld.

The effects of bad governance

We can see the effects of bad governance and the benefits of good governance by making comparisons between countries within Africa because, despite the bad press that Africa gets, there are some countries, not many but a few, that have actually made significant progress. And time and again, when we compare these countries with those that have made no progress, the ingredients of success are obvious.

Compare Nigeria with Botswana. Botswana is land locked and has nearly 40% of its population infected by Aids — not a promising background. Yet it has had a high economic growth rate for years and has average income per head of £2,000 per annum: about ten times a dollar a day. The US Department of State says about Botswana, “The legal system is sufficient to conduct fair commercial dealings” and the government has “abolished all exchange controls...[has] undertaken largely successful efforts to combat crime, including corruption, and to improve the delivery of the judicial system”.

Nigeria has great oil wealth, but an average income of less than £100 per head. The Economist Intelligence Unit says of Nigeria, “as much as two-thirds of all economic activity takes place in the informal sector” (that is the black market) and that corruption is “what brought the economy to its knees...Transparency is lacking and financial malpractices are deeply rooted at all levels of public administration”.

It is remarkable to think that Nigeria’s income per head was equal to that of South Korea’s just 50 years ago, now it is just 5% of the South Korean level.

There are plenty of other examples that make the same case. But I want to move on to the more subtle issue of the definition and enforcement of property rights to see what effect it has when governments do not perform their basic functions in this respect.

Hernando de Soto, a Peruvian political economist undertook practical work in Peru to examine the impact of the lack of definition of property rights and the inability of businesses to

get legal recognition. These are the kind of costs imposed on businesses that cannot incorporate legally (and therefore have to operate illegally or lose their livelihoods): they have to shelter their activities from the tax authorities and probably pay bribes to them; they cannot obtain any credit except from informal money lenders; they cannot obtain long-term finance (issue shares etc); they cannot have limited liability; they have no insurance coverage; they are forced to divide their production activities between many sites so that no site becomes big enough to be seen by the authorities; and they cannot advertise their products. In Peru, on average, 15% of turnover in manufacturing is paid out in bribes. To become legal and register its property (without using bribes to oil the wheels of the process) it takes a small business in Lima over three hundred working days, working 6-hours a day — just on the registration processes: that is thirty-two times the monthly minimum wage. A person living in a housing settlement where title was not formally registered would have to go through 728 bureaucratic steps to register title with the city of Lima authority alone. De Soto describes all the informal businesses and housing units as “dead capital”. The houses can be lived in and the people who have the businesses can live a hand to mouth existence, but economic development is impossible. The value of all these extra-legal assets is five times the value of all the assets on Lima stock exchange and 14 times the value of all foreign direct investment. In other words, Peru has a great capital base but the owners cannot use their capital, cannot run their businesses, have to make informal contracts that cannot be enforced in the courts, cannot buy and sell their houses or businesses and so on. Politicians, judges, the police and so on benefit greatly from these arrangements. Bribery and corruption are necessary to

obtain legal sanction, because contracts do not have any legal authority. This is not just anecdotal, the Economist Intelligence Unit reports that, “The Peruvian Judiciary is plagued by corruption.” In a different country, with the same problems, India, The Economist reports that, Delhi’s 250,000 bicycle rickshaw pullers collectively pay bribes of 20m-25m rupees a month for the privilege of being allowed to pursue their profession.

There is no point going through further examples throughout the world. But, just so that you do not think this is a problem specific to Peru, the World Bank and the International Finance Corporation has just published its third, *Doing Business* report. Here are some sample statistics from it, and a few more from elsewhere:

- The start up cost for a business in Zimbabwe is 14 times annual income.
- In Belarus, a business has to pay 11 separate taxes, involving 113 payments to three different agencies, taking on average 1,188 hours to complete the administrative process (Belarus has an average income per head of £1,000 per annum, less than 40% of that of nearby-Estonia).
- Of the 30 countries with the greatest legal obstacles to business, 23 of them are in sub-Saharan Africa.
- In India, it takes 89 days to start a business and ten years to complete insolvency procedures.

Questions for Discussion, Central and Eastern Europe and Africa

The question I was asked to consider was, “what are the differences between Central and Eastern Europe and Africa?” Really, I want you to have a more general discussion on this question, but let me make some suggestions of possible issues to discuss.

The issues I have raised relate to universal truths, more or less. Traditions and contexts differ but one needs property rights, freedom to trade and enforceable contracts to develop any market-based system for the allocation of resources. We can certainly make similar comparisons between countries in Central and Eastern Europe as we have made between countries in Africa. Compare Poland and the Ukraine. Poland has an income per head more than four times that of the Ukraine. The Heritage Index of Economic Freedom certainly has critical things to say about the security of property rights and judicial processes in Poland. But the EIU reports that, “firms generally speak well of the local court system...especially compared with the systems of neighbouring countries”. Bureaucratic burdens are certainly acknowledged and considerable and there is a high level of informal market activity. However, there is no doubt that these criticisms are made in comparison with Western standards. In the Ukraine, things are much worse. “Organised crime is said to influence the judiciary” according to the US department of state. Also “Private investment is greatly hampered by corruption, over-regulation and lack of transparency.” Looking at reports on and national income of other countries, such as Albania and Belarus, and comparing

them with those from countries such as Estonia and Slovenia, one sees a similar pattern.

So is it true in Central and Eastern Europe, just as it is true in Africa that “good governance”, as I have defined it, is the key to successful reform? I would suggest that it is and that the emphasis should be on secure property rights, getting rid of corruption and enforcing contracts. But, paradoxically, it is also important to realise that these things are related to having a small state. Having the state effectively doing what it is supposed to do requires that the state has an insignificant role in allocating economic resources and regulation. Thus privatisation, de-regulation and low taxation need to develop hand-in-hand with the state developing its capacity to perform its proper functions. There are exceptions to this general rule. The Scandinavian countries seem to have a remarkable record in terms of corruption, ensuring the rule of law, enforcing contracts and protecting property rights, with a very big state. But, this is the exception.

Some differences between Africa and Central and Eastern Europe are worth considering. Does it make any difference that post-communist economies started with a completely different set of conditions — for example some had traditions of contract and property rights from before communist times, almost all had an industrial base and trading relationships, and in very few cases was absolute poverty anything like at African levels? Have those countries that have a more recent history of developed capitalist society fared better than those which have not (for example Poland compared with Russia)?

How should we treat property rights from before communist times? If we are talking about the importance of private property, it is important that these issues are resolved quickly and with certainty of title.

What is the benefit and cost of international organisations? For example, the EU, from an Anglo-Saxon point of view, can be regarded as a dirigiste regulator. But, it could also be regarded as a body that can at least assist in ensuring that the basics of good governance remain in place.

With these questions I end my formal contribution.

Ljubo Sirc: Thank you. I shall now introduce Rado Pezdir of the Institute for Civilisation and Culture, who spoke at our meeting last year. Welcome back, Rado.

**Postwar Germany and Post-communist Slovenia:
Lessons of success and failure
by Rado Pezdir**

I will speak about post-war German and post-communist Slovenian transition. We all know that there were similar initial conditions. Collectivism existed in both countries, there was one-party rule, and they had command economies. But we see that the two transitions were quite different. While post-war German transition was a success, the Slovene transition is now considered to be a failure. There is much hard data to support this. First of all, I think the voter is involved in the economy. So when the institutional framework is being changed the informal institutions also have to be. Reforms of the political system are dependent on and connected to economic reforms. I will look at some of the initial conditions of both transitions.

Slovenia started transition with a socialist legacy, one ruling party, no proper party system, and central planning. The early history of Slovenian political system could be described as a liberal autocracy of the Austro-Hungarian Empire. A system which provided economic freedom and rule of law without political freedom (Pejovich, 2001). The political transition originated in two ways. First was the development of a political opposition in the late 1980s. The second was transformation of the Communist Party which was barely affected by opposition but greatly influenced by the breakdown of the Yugoslav Communist Party. The national conflicts within the Yugoslav Communist Party provided the chance opportunity for the Slovenian Communist Party to promote itself as a national left wing party, opposing pressure

from Belgrade. This gave them a status similar to that of new parties. However, many of the informal connections to 'old boy networks' in state owned enterprise have survived. Former communists throughout Slovenian society entered political life in new parties, whilst retaining their positions in state owned enterprises.

The socialist economy in Slovenia was dominated by central planning. Economic policymakers had a preference for heavy industry. There was no financial system, no private property or rule of the law such as that in capitalist countries. Markets were monopolised and distorted by large state owned enterprises and entry and exit to markets were heavily regulated by central planning. Prices were administered, especially in services where there were extreme distortions (health care, education, transport, energy). International trade was limited by tariffs and government intervention. The management of state owned enterprises was almost exclusively selected in agreement with central planners and ruling communist elites, and competitive pressure barely influenced the process of manager selection. Finally, the link between politics and the economy was very strong.

German political life before transition was much the same as in communist Slovenia. The National Socialist Party had monopolised power and any opposition was illegal. Similar to Slovenia's experience when part of the Austro Hungarian Empire, historically Germany had also experienced liberal autocracy. However, the national socialists were in power for a much shorter time than the communists in Slovenia. Therefore, informal institutions in Germany did not have to change as much and also under such circumstances one would

expect fewer interest groups to try and transform collectivist informal institutions.

The German economy under the national socialists was a replica of the communist command economy with central planning and strong preferences towards heavy (war) industry. However, private property rights were not abolished whereas private property could not exist under communism. Despite that, private property was extremely limited. The National Socialists viewed private property as conditional on use – not as a fundamental right (Temin, 1991, p. 576). They introduced contracts with special groups in industry who were obliged to sell their output (in many cases limited by quotas) at administered fixed prices. Another case of the violation for private property rights was the establishment of the Hermann Göring Factory: a gigantic organisation to provide desired output at low prices and to further German despotism. The Hermann Göring Factory was a threat to private companies, which were taken over if contractual obligations were not met.

Like Slovenia, Germany was also moving towards autarchy, mostly by controlling and restricting international trade. The main instrument of such economic policy was the refusal to devalue the Mark (Temin, 1991, p. 580), following the pre-National Socialist restrictions on international trade (trade tariffs). A policy encouraging enterprises to organise in cartels was initiated in order to limit competition and foster state control over private enterprises. Barry (1993) describes the German economy under the National Socialists as being subjected to rigid controls, price fixing, rationing, and a hopelessly inefficient monetary system that produced ruinous

economic results. Output plummeted, the black market flourished and barter had replaced normal monetary exchange. Full employment was maintained, but only by a system which produced goods that nobody wanted.

Both political and economic life under socialism in Slovenia and National Socialism in Germany were distorted. The economy was distorted by state owned or controlled monopolies (cartels) whilst political power was in the ruling party's hands. However, there were slight differences in initial conditions, although with little effect -- except the length of time -- on the final outcome. For example, in Slovenia communists in every level of society dominated the economy and politics and it was common practice for managers of state enterprises to be nominated with political approval. In Nazi Germany the process was reversed. Private enterprises were exposed to state control and many entrepreneurs were involved with planning processes (either by creating interest groups through cartels or by direct participation in the planning bureaucracy). This enabled entrepreneurs to enforce their informal institutions in institutional frameworks. In both countries property rights were violated, although Germany did not confiscate property as such.

Both economies were unable to keep pace with innovations in capitalist economies. This could be attributed to the exclusion from international trade, to suppressing private initiative and to preferences of central planners for heavy or war industry. Both sectors in both countries were interconnected and opened to invasion by informal institutions of various interest groups. The institutional framework was the result of such mechanisms.

The Slovene political system moved towards transition with the first elections in 1990. Although the former communist party did not win, old boy networks in the economy survived and contributed to the reconstruction strategy in the economy, privatisation methods kept foreign investors out of the reconstruction. This had important implications. Aghion (2002), for example, stressed the importance of foreign investors in exerting pressure on inefficient state enterprises to innovate. In the absence of foreign investors there was no such pressure. The second is that distribution of property rights over state owned enterprises caused ownership to be transformed from the largest owner to the major owners of the enterprises, and the old boy network ensured their positions in the economy. Foreign investment could not act as a mechanism to introduce more enterprises into the state-monopolised distorted markets.

Another problem connected to distribution of property rights was the fact that the first elected government took very gradual action. Instead of reforming, introducing the rule of law and private sector, government feared that reconstruction would be too costly in unemployment terms, it decided that more should be done to prevent overall destruction of inefficient large state-owned enterprises thus sending many workers to the unemployment office. The fact that Slovenia was relatively well off at the beginning of transition, compared to other ex-socialist countries, countries supported policy makers in the idea that transformation did not need to be as radical as in other countries.

It was important for the ex-communist countries to maintain some of the old welfare systems, no matter how inefficient, since a successful transition will inevitably involve hardship as old and useless industries are liquidated (Barry, 1993, p. 14). This means that institutions remain vulnerable for interest groups. In such circumstances old interest groups have survived and new have been created – maintaining the welfare from the former institutional framework and the preference to subsidise rather than reconstruct state owned enterprises.

What was the economic policy of Slovenian transition? Administration of prices was preferred to liberalisation, economic policy makers manipulated exchange rates to stimulate exports (constant depreciation of nominal exchange rate). State owned enterprises were heavily subsidised and some “eminent” Slovenian economists even advocated autarchy – to create conditions under which both private and state sector could develop satisfactorily before introducing foreign competition. Economic policy makers took an active policy approach by setting up a fund for the reconstruction of inefficient state-owned enterprises. Monopolies were encouraged in several sectors, particularly industries such as energy, gas, electricity, fixed and communications, banking, insurance, retail, processing of food etc. in order to “prepare domestic enterprises for stiff foreign competition”. Mutual ownership between state-owned enterprises was not unusual, and foreign investments were discouraged by heavy administrative burdens that were only abolished in 2000 and most of the agriculture was not exposed to foreign trade, with administered prices and central planning quotas. Almost all economic policies were consolidated within a social partnership, constituted by unions, the largest being the ex-

socialist union; enterprises, that were owned mostly by the state or old boy network enterprises and government, consisting of reluctant reformers or ex-communists both maximising their political life.

This had enormous consequences for Slovenian transition. Fifteen years after the transition process started, Slovenia has been the slowest country in the region in withdrawing state mechanisms from the economy. The private sector share in Slovenian GDP is among the lowest in transition countries in central and east Europe. Subsidies are among the highest, administrative barriers among the most burdensome; the labour market is the most rigid and the tax burden the highest. It is no surprise that the demographic picture of enterprises has been the grimmest in the area, not counting Poland.

So after fifteen years the data suggests that Slovenia is lagging in reconstructing the economy, is relatively less innovative than its transition counterparts and consequently competes in international markets with less technologically advanced products and services than other transition countries in central and eastern Europe. Probably the most devastating result is its constant decline in the index of economic freedom. In 2005 it indicated that Slovenia has the least free economy in the region. Little had changed much since pre-transition times.

German transition emerged from a ruined political system and economy. After the collapse of the Third Reich, the Allied Occupation Powers began reconstructing Germany. The country was divided into two parts. The Western part under Anglo-American occupation was transformed into a capitalist

democracy whereas the eastern part under the Soviets became a centrally planned economy under communist rule. We shall analyse only the transformation of western Germany, as the institutional framework of the East did not differ much from Slovenia's.

German transition started with denazification. The National Socialist Party and its various organisations were outlawed and the leaders sent to prison or to the gallows. Lesser functionaries were barred from important positions in public life (Pejovich, 2001, p.31). This efficiently destroyed most of the interest groups within National Socialism. Only after denazification and initial restructuring of the economy were the first elections held in 1949. This prevented political parties from attempting to slow down the pace of reforms in order to collect votes, as old interest groups were gone and reforms started to show first successful results. Further, this reduced the possibility of interest groups emerging and taking control.

Today we know that Allied Occupation Powers did not plan to create a liberal economy. In the spirit of the time they tried to enforce some sort of Keynesian planning. However Ludwig Erhard established a liberal economy by introducing the new Deutsche Mark. This was almost immediately followed by lift of price and numerous other controls. He also avoided expansionary budget policies to mop up the problem of unemployment, a consequence of the removal of controls (Barry, 1993, p. 9). Although prices rose sharply after controls were lifted in 1948, price levels remained constant from 1951 to 1957 (Sohmen, 1959, p. 959). Germany also implemented liberal trade policies, which were the best way to protect

market competition and suppress development of market distortions.

The German economy also closed the technology gap very successfully, which could be observed by the steep growth of total factor productivity (Gilchrist, Williams, 2001). In other words the German post-war economy was thoroughly reconstructed. By liberalising international trade not only was competition stronger but there was also pressure to reconstruct and innovate. This was something that Slovenia was rather unsuccessful at.

Yet another important factor for fast and efficient transition was entrepreneurship. Although there is not much evidence of the extent of entrepreneurial activity in West Germany relative to other countries, we can speculate that the environment for entrepreneurship in other countries must have been much less encouraging. In other European countries socialist planning or Keynesian policy making dominated, while Germany had a liberal economic policy. However there were two additional reasons that made the transformation of the German economy easier. First, that much of German pre-war heavy industry was destroyed during the war. And second, refugees from Eastern Germany (escaping from Soviets) and other part of Eastern Europe (Volksdeutsch) gave the German economy a great entrepreneurial push. Held (Held 1956) estimated that probably almost more than half of all businesses after 1945 were established by refugees. This enabled unemployment to be reduced and the private sector to develop. In Slovenia, there was no initial entrepreneurial push and the big state-owned enterprises dominated the economy.

The result of these changes was strong growth as GDP rose from 1953 to 1963 at average rate of 6.7 percent (Barry, 1993, p. 9). Besides that growth rates were the highest among the more developed countries (see table 16 in appendix).

Despite very similar initial conditions of both transitions, Slovene transition was far less successful in creating the institutional environment in which a capitalist economy could operate. Instead patterns of informal ex-socialist and new interest groups were actively determining the formation of a new institutional framework. After the initial destruction of a party system, voters became more rigid. Old boy networks in the economy survived and supported slow transformation of political market and economy in many different ways. Overall monopolies by state enterprises, support of state owned enterprises, slow privatisation and social agreements directing the outcomes were only a few of the mechanisms inhibiting Slovenian transition.

In Germany the situation was the opposite. Markets were liberalised, restrictions were lifted and there was no state interference in the economy by misusing a fiscal policy. Interest groups diminished with denazification, abolishment of regulations and by the fact that political market did not exist for years. When a democratic political system started, the economy recovered to such an extent that political parties were unable to calculate and maximize their political cycle by slowing down the reforms. As we have seen in Slovenia, political parties attempted to support interest groups by providing expansionary fiscal policies for subsidies and artificial reallocation.

What could have been done better? First, Slovenia did not have the advantage of postponing elections to the latter stages of transition, where the influence of interest groups would diminish. And, as Barry (1993) noted, some areas of the old welfare system had to survive. This meant an open invitation to all interest groups to join in the political redistribution of wealth. However, if policy makers would concentrate in providing (Pejovich, 1993, p. 77): (i) equal legal protection of property rights, (ii) equal fiscal treatment of all sources of income, (iii) efficient financial markets, (iv) open entry and exit in all markets and (v) free access to foreign goods and capital, this would make for a robust institutional environment resistant to many interest groups. Also it would force political parties to compete for voters on the basis of successful reconstruction and not attracting interest groups by providing rents and subsidies. More effort should be made to remove the bureaucracy instead.

Secondly, Slovenian policy makers opted for too much autarchy. They obstructed foreign direct investments. Privatisation meant redistributing wealth in the interests of the state and interest groups. Foreigners who could act as competition pressure and break down old boy networks were excluded, and overall liberalisation did not follow.

Thirdly, entrepreneurship was neglected as support was provided to the state owned enterprises. It is no surprise to see a plethora of regulations and administrative barriers in Slovenia, since the primary goal of policy makers was to ensure continued connections to the interest groups in the state sector, not in fostering entrepreneurship. We have shown that one of the most important mechanisms to reduce

unemployment in Germany was the abolition of regulations and a strong entrepreneurial push. In Slovenia they tried not to begin reconstruction in order to avoid an increase in unemployment.

Fourthly, government policies inhibited transition. In Germany there had been no place for Keynesian fiscal policies, while in Slovenia they were widely used. Consequently, interest groups were encouraged to join redistribution. Subsidies, special funds and discretionary actions (such as depreciation of nominal exchange rate to support exporters) were common features of the economic policy. Social agreement between social partners such as ruling parties, unions and employers, mostly from state owned enterprises, determined interactions on the market thus driving out the market mechanism.

In conclusion, when comparing post-war German transition and post-socialist Slovenian transition we observe huge differences, despite more or less similar initial conditions. Most differences could be explained by the process of informal institutions, which originated in the old institutional framework, distorting the new institutional framework by interfering in reconstruction and policy-making. The consequences are devastating – distorting the political market and economy and finally inhibiting transition. Slovenia is such a case. In my opinion this is one of the most important parameters, which explains why transition in post-war Germany was so different from that in Slovenia. Since both sectors of society both political and economic are in constant interaction and players act as both voter and market player in the economy, it is important for policy-makers first to build

robust institutional frameworks and secondly to foster liberal reforms. The German example demonstrates this clearly.

Ljubo Sirc: Thank you, Rado. Both you and Philip have given us much to discuss so now I should like to take comments and questions.

Bob Reilly: Professor Booth, I sympathise with everything you said. If you look at the constitutions with which so many sub-Saharan states were endowed by their postcolonial rulers, particularly the British, they are close to impeccable models embodying the rule of law, the separation of powers, and so forth. So in principle they seem to have in place a system of governance to achieve the ends, but as you said all of them failed. Why is that?

Philip Booth: It is difficult to say, because I am not sure the reasons for failure are the same in all of them. I think we have just heard a very good exposition of why democracy and good governance do not necessarily go together and can in fact contradict each other in terms of realisation of the objectives one wants to see. In many cases some form of absolute democracy was established and in most cases that absolute democracy led pretty quickly to either some kind of one-party rule where that party controlled the constitution and also came to control all aspects of political and legal life and so one lost the separation of powers or, as with Nigeria, democracies were established in countries which had previously not been what one would describe as a unitary, settled country containing peoples with a common tradition, etc. and democracy fell apart into civil war. In Uganda democracy was overturned by dictatorship.

So if you take world history as a whole, there are not many countries which have developed all the things I have talked about here — civilised democracy, enforcement of property rights, the rule of law, development of prosperity, and so on, I think the ingredients which you have to put together are quite complex, and cannot be written out in a textbook. They sometimes have to be developed by a process of trial and error, and be appropriate for the traditions of the countries concerned. Occupation is perhaps necessary to produce these. Japan managed to produce similar development to Germany after the war as a result of occupation.

Silvana Malle: Where do we go from here? What are the policy recommendations for Africa or Peru or even Slovenia? If we can do something useful, we should try to see what can be done. I do not see from either of these presentations any way out. If we were not politically correct we would revert to colonisation, with some countries under the protection of other, better countries, and after a number of years these countries would be able to set up their own institutions and make them work. Democracy does not work in these countries, and neither do homegrown dictatorships. Would we be so courageous as to advocate colonisation? I would not. You say no foreign aid, and I am also against economic aid because it goes into the wrong hands. But in the form of assistance to NGOs, through education, and so on, building up civil servants — this should be our purpose. This will take time to build.

I would also criticise the complacency I felt in both papers. Here we are, Old Europe, and we are better. We were always

better. But just look at the arguments in France before the referendum on the European Constitutional Treaty — they were Soviet-style: let us protect our business, let us protect our wages, let us protect our plumbers, let us convince Estonia to raise corporate tax because otherwise our enterprises will invest in Estonia — these were the arguments. Look at Germany now: with a stagnant economy. We see the results of the elections: a liberal party in power, and that is good, but it's 10% of the population. Let us take the debate in Italy. Again we are finding remnants of the left-wing programmes of the 1970s. People do not even discuss the fact that there is an enormous public debt and fiscal deficit. Look at Britain. It did well under Blair, let us see if changes. It is better than most countries in the EU because of Keynesian fiscal policy and of course Britain was not caught in the exchange crisis like the rest of us. But there are problems everywhere and I would caution against being too complacent.

John Moore: I think there is a vast difference even between France and Nigeria. In any case I wanted to come back to the points raised by Bob Reilly on the failure of constitutions. I think it relates to an issue in both papers, which is this matter of what I would term following Pejovich — the difference between formal and informal constitutions and the problems these cause for transition. I am sure many of you have read Steve Pejovich's papers on this subject, in which he argues that if we think of the process of transition, what we are usually talking about is incorporating new institutions into a society — political, social, economic institutions. These are usually in the form of formal institutions — rules, regulations, laws, etc. that are imported or just dreamed up.

Steve's argument is that the greater the difference between these formal institutions being introduced in the process of transition and the informal institutions of the society, the more costly transition will take, the longer it will take, the less likely it is to succeed. I was talking to Vitaly Naishul about the problems of a constitution for Russia, and for him the problem goes very deep — the problem of language. He argues that there really is no common language in Russia; the elite understand the words of Russian in a different way from how other people understand them, and as a result Putin has never addressed the nation as a whole, because they cannot find the language for him to communicate to everyone. When you are in that situation it is very difficult to understand how a constitution could be written which would relate to all the people. I have also been talking to scientists in a couple of countries including Armenia. There the problem, and that is also true for Russia, with reforming the scientific establishment is that under the Soviet system all research was carried out in the institutes in the capitals, and I think everyone understands that this is not a good way to organise scientific research. But the problem is getting the old generation to accept something different.

It also occurs to me, with reference to the problem of formal versus informal institutions, that in the American Constitution, which is generally regarded as quite successful, it was radical in one sense because it resulted in republicanism in place of the British monarchy, but informally the institutions had evolved in that direction. This meant that when the constitution was adopted it was a ratification of what already existed, rather than an imposition

of a new set of formal institutions. This brings me to Silvana's question. What do you do? I suppose one place to start is to think about the informal institutions and trying to help ease the transition in ways that are not too distant from the informal institutions.

Vladimir Benacek: I have a question about ultimate objectives. It is like finding an ultimate cause. Slav economists try to find ultimate causes and models, but they never exist, because each ultimate objective has certain instruments and these instruments become secondary objectives, and so on. So what we see in case studies is that some countries start and get to a very efficient equilibrium that is self-sustaining and lasting. In Germany it lasted fifty years, but if you look at Germany now I think it is an example of shocking collapse — a society which got to an equilibrium of inefficiency, and I am afraid it will be eternally returning to that inefficiency whenever they try to make it better. So my question is, what is the policy instrument that would break the inefficient equilibrium and drive the country towards finding a new equilibrium that will be efficient. This is quite tricky, but transition countries have shown that this can actually happen.

There are now eight new member states in the EU, and at one stage each of these was the underdog — there were disastrous economic policies, and later these countries became some sort of paradigm. But we should go back and look at what happened; I think one of the instruments was a crisis. We generally see crisis as a disaster, but for societies which got caught in an equilibrium of inefficiency this is a prisoner's dilemma. I think there are no unavoidable cases, where some

countries soar and are forever success stories. Sixteen years is nothing, and within these sixteen years some countries, like the Czech Republic, went up quite well, and then in 1997 there was an exchange rate crisis. But there was a certain catharsis which the Social Democrats benefited from, so that finally we have a market economy and the question of sustainability and efficient markets have certain conditions. We should try to establish what determines an equilibrium of inefficiency, and how to get out of it.

Philip Booth: I was not saying there were some means which would give us the ultimate answer in all circumstances. I think there are some issues such as the enforcement of property rights, contracts and basic freedom under the law, which you can derive from natural law, and that there are some goals which one should strive for. But the actual cultural contexts of nurturing these institutions and values is going to be very different in different countries. One of the problems is that democracy is an extremely imperfect instrument for achieving the goals we want to achieve, and it is probably, as Churchill suggested, the best of all instruments available in most circumstances. That is why one can get stuck in an equilibrium position, because the political marketplace does not necessarily bring you to a result, in terms of economic goals, that you would like. It is simply better than alternative mechanisms for achieving economic goals.

So given that we have this imperfect mechanism, will a crisis help democracy reform in the right direction? It might, and the UK is another example, as it slides slowly into a more socialist orientation, and the free market economists in the Conservative Party wonder whether there will be popular

enthusiasm for them to govern again, as there was in 1979. There is no question that the crisis which developed in Britain in the 1970s is something which was instrumental in bringing Margaret Thatcher to government. The crisis which develops in several countries does sometimes bring about a beneficial change in government. But that does not always happen. Very often, if you read Hayek's *Road to Serfdom*, a crisis brings about precisely the opposite response — people are disillusioned with the chaos of democracy and elect somebody who will get something done, a dictator who will organise things more sufficiently. So whilst it may be true that a crisis is sometimes a necessary condition in jilting a democracy into action or better government, one should not be confident that it will necessarily lead to the right results.

Rado Pezdir: I agree to some extent. I am sure there are examples of crisis fostering reform, but what I was saying is that the Slovene and German transitions were different. The basic difference was the discrepancy between formal and informal institutions at the time institutions broke down, and the way policymakers reacted and how the political market and economy reacted to their responses. There is no happy ending to any story. We know from the German example that after 15 or 20 years of economic success there was a downturn. It started with working co-determinations and laws like this. So what would I say for Slovenia now, after losing 15 years? I think Slovakia is a good example, showing that all need not be lost and much can be done. Policymakers do not care about maximisation of the political cycle; they simply do the job. If the job is not done, nothing is done. This is what politicians should do, not collect interest groups or votes from them.

John Moore: 9/11 was a great crisis in the US, and what came out of that? More bureaucracy in the form of this enormous Department of Homeland Security, which pushed the United States in the direction of more bureaucracy, and did not do much else. I think it shows that crisis can push a country in a direction that is inconsistent with its customs and traditions, and unfortunately that has become the case in the US.

Ljubo Sirc: That is a question which concerns not only economists, and we tend to forget that the world does not consist only of our worries but many others. Sometimes politics takes precedence and it has a very bad influence on our concerns.

Krassen Stanchev: Regarding the post-war reconstruction. Basically the restoration of 1938 GDP per capita was in most of Europe by the end of 1947 and at worst by the end of 1948. This meant there was a period of three and a half to four years after the war, and of course it was a time of reconstructing the foundation of the economy. But if you compare the period of reconstruction to the period of post-communist reconstruction, most of the restoration of pre-reform GDP levels took at least seven or eight years, sometimes longer. The basic explanation in the literature was that even in Nazi Germany private property was reinforced in contracts, resolved in disputes, and the normal functions of inheritance procedures were carried out. This was not the case in Eastern Europe, and perhaps this is one of the ultimate explanations why the restoration of pre-reform levels of GDP and other indicators took twice as long as in Germany.

So in this respect Slovenia is outside the common pattern, for many reasons, but first, there was no physical reconstruction, and second, probably more important, 60% of Slovenia's trade was with what is today the EU. If you compare with Czechoslovakia, 56% of her trade was with the Soviet Union. For Bulgaria it was 80%. So there was a tremendous need for an effort to re-channel all transactions, find new partners, and re-establish the industrial base, and so on, which was not the case for Slovenia. Slovenia did not need to restore.

My second point is on the right to remove. It was been widely used in Central and Eastern Europe. There is no single case except for Slovakia, where an incoming government managed to stay for a second term. The voters were always kicking the incumbents out. The last case was Slovakia, with poor prospects for the reformers staying in power for a long time, so perhaps there will be somebody else to continue the reforms they started, but it is a very interesting phenomenon.

This is not the case in Slovenia, where they were quite successful in sustaining the old boys' network. This is probably a major reason for dissatisfaction and discontent in Slovenia. In other countries it was a major phenomenon that each and every incumbent was kicked out in the next elections. This constant turnover led to a situation in which many of the former Soviet Union countries an oligarchy formed. But this was because the reformers' failure to secure a stable majority, not because of ex-communists getting significant electoral support. Anders Aslund wrote a paper on this last year comparing the oligarchies of Russia, Ukraine and the United States in the 19th century. You immediately

identify the difference between Central and Eastern Europe, and the former Soviet Union — the fact that the democratic turnover basically saved those countries from oligarchies. Bulgarian socialists and ex-communists managed to contribute to 60% inflation tax for two years. And of course this is nothing compared to Milosevic's policy in Serbia.

For some reason, however, nobody is paying attention to these disasters and crises in Eastern Europe. There were greater economic crises and disasters in Eastern Europe than in Africa. So how did they manage to overcome these? One explanation is the informal institutions. The second issue is constitutional. For some reason these informal institutions provide a better background for smooth government in Eastern Europe than in Africa and the Soviet Union. The third reason is probably that these countries are somehow better positioned in comparison to Africa to gain from globalisation — from international transactions, from the fact that the governments are going to collect less money, and so on.

Bernard Brscic: I want to address the extent to which development economics contribute to the improvement of the situation in Africa, or in transition. If one looks at the purpose of development economics over the last 30 years, one sees a mental change of focus. In the beginning there was an emphasis on neoclassical growth models, which emphasise the lack of capital in the undeveloped countries. At the end of the 1960s the focus changed from physical capital to human capital, and that was the prevailing agenda in the development community — underdeveloped countries need a transfer of human capital, which meant basically that the students from developing countries were studying in the West, but that

failed. In the 1980s, again there was this change of development paradigm. We know that it is the institutions which matter. The problem is which institutions? There is the dichotomy of informal and formal institutions, or internal *vs* external. The problem is that formal institutions can easily be transplanted. You need a couple of years to transplant the best laws there are in the West. But how do you change informal institutions?

Steve Pejovich uses the wonderful concept of interaction thesis — basically, you cannot transplant certain formal institutions which are incompatible with existing informal institutions. The development literature has progressed immensely in the sense that we do know which institutions are conducive to wealth creation, that the rule of law is absolutely vital in that in terms of protection of property rights. But what we do not know is how to change informal institutions into ones compatible with a capitalist system, delivering goods and services that people want. In this sense, the question arises: what can politicians do? Silvana Malle was advocating a progressive strategy of increasing technical aid. I doubt this is the way to proceed, because these efforts failed in the past. What the West could do is basically open the market. It is not aid which is needed, but trade. In the past there was a loner in development economics, Lord Bauer, who was constantly opposing foreign aid that just supports the indigenous dictators. We know from Adam Smith that it is trade which fosters economic growth and that it is conducive to wealth creation.

Regrettably the markets in Western countries are closed for the goods that the undeveloped countries have a comparative

advantage over, which means that all the agricultural imports are either subject to import duties or certain quotas, and at the same time the products that the developed countries have a comparative advantage over are of course through the process of GATT and the WTO almost totally protected. We can help the less developed countries by opening markets and allowing the farmers access to European and American markets.

Matej Kovac: We heard that a crisis is somehow a good start to reforms, but an authoritarian regime can also act defensively in a crisis, so the crisis can actually make a situation worse. So growth can be a question of what the incentives, in a crisis or outside a crisis, which encourage or critically leads the population to accept reform and exploit this window of opportunity and it is my feeling that it is not a single incentive but numerous incentives, such as business creation by immigrants and expatriates. This is something that may now be quite relevant for some poor countries like Albania and Moldova, which have many expatriates sending money back to relatives. In some other countries, such as Croatia and Poland, this was also a mean of revenue.

I cannot think of a single reform in Slovenia that was not made under pressure in this past year. All recent laws were made under pressure from the desire to join the European Union. I believe that some countries joining the WTO might be a good incentive.

Openness to foreign trade is very tricky because of openness to free movements of people. Trade and free movement of people contribute to voter incentives. Voters see that these freedoms may come in their lifetimes rather than in the distant

future. In Slovenia we do not exploit the freedom to move freely across Europe. We are not in the queue at a UK employment office like those from the Baltic States for example. We would like to be treated as others are.

Natasa Srdoc: Philip Booth asked how do we establish characteristics of good governance in transitional countries that have moved from dictatorship to democracy. We can see the difference now. The political leaders are interested in being re-elected and so react to pressure from the media and the international community.

International pressure can also contribute to the aforesaid leaders making certain moves faster than originally planned. In Croatia we have noticed that international pressure can force politicians to do certain things for economic reforms for betterment of the people and therefore the country. We need positive examples and we need to feature them in the media from the grassroots level to see the difference. Unfortunately in Croatia we see, as Silvana Malle mentioned, the negative example of USID helping to fund a National Competitiveness Board which was established as a social partnership consisting of trade unions, government and big business. But of course the state has the majority shareholding in the large businesses. All of a sudden trade unions no longer had a say in Croatia and in other transition countries there were no trade unions. For the USID to fund that kind of institution is not really a good example of sensible policy. We in our respective countries should try to voice our opinions of our taxes being used in other countries for the wrong purpose. For we do not believe in big government and the trade unions putting straightjackets on many decisions being made.

Another example of so-called irregular takings, as it is defined in the United States, which is not defined at all in Croatia, no compensation of a country where property rights are fully protected and the law upheld and I wonder how many other countries have governments who declare a green area without compensating the owner. I realise there is no country that has clear rules whereby property rights are fully protected and the rule of law is upheld. Still, the planning and zoning of these green areas is decided very arbitrarily and compensation does not follow. It is the same unfortunately in the United States, United Kingdom, Austria and Italy.

If we wish to put forward arguments for transition countries it is very helpful to cite positive laws and practical examples from the West, but we cannot come up with these examples. We have to debate these issues without the good example. The objective of government is to be re-elected and our objective as a free-market think tank is to change public opinion. We wish to remove that xenophobia when it comes to privatisation and let foreign direct investment in, and also to educate individuals of the benefits of free markets and to demonstrate that it is not governments that have to provide everything. This negates economic freedom and stunts economic growth.

Andrzej Brzeski: Tolstoy said, in *The Death of Ivan Ilyich* I think, "all the happy families are the same and only the unhappy families are different from each other." or something to that effect. This applies, *mutatis mutandis*, to our discussion and I think all the successful countries share those things we talked about: *Rechtstadt*, property rights... But I

think something in the discussion is under-emphasised and that it is energetic people who provide the supply of entrepreneurship.

It is the special circumstances that come into focus in Rado Pezdir's paper on Slovenia and Germany. Well, there were special circumstances then. First, Slovenians are not Germans whatever that implies. Secondly, at that time there was the Cold War with Stalin looming over Europe; there was the Marshall Plan to deal with those problems at a state level. So the context, the circumstances were completely different and I did not think this came out clearly enough in the paper. We shall have to recognise the fact that there are many specifics in this case and one has to act accordingly. I was reading on the plane a lecture published by the IEA by Doug North on economic growth. He talks about China and he says the Chinese case is one in which there are no well-defined property rights, but the fact that the party delegates the supervision of economics to the regional authorities. And of course there is a tie between the so-called entrepreneurs and regional bosses who get a kickback. That in effect provides a stable, if not a well defined working system of "property rights", to what extent this has changed I do not know, but I think it is still the case.

Silvana Malle: I fully agree that free trade is a powerful means of moving things. Of course, I think you address this issue to us and not to the other countries. It is in the 'Old Europe' and United States where there are many subsidies particularly in agricultural policy and now there is the debate on the textile industry. Everyone knew that in five years the multifibre agreement starting in China would come about, and

when China started exporting textiles this immediately resulted in protectionism, and this is an argument against our complacency. We are doing wrong. I fully agree about free trade on our part but we did not do enough. But it does not rule out the question of assistance, and I mean assistance in education. I do not mean assistance in copying our institutions, as countries will choose the institutions they want but you have to prepare people. I would underline that in China an extremely important factor has been that a number of Chinese have been accepted to study in the United States and also the United Kingdom among other countries, and at least half of them have returned home. And they are constituting the layer of the new leadership and gradually are taking positions in institutions and in government. Something that Russia did not have.

Touching on Russia, that was extremely important because we still have in Russia a number of reformers who benefited from the kind of assistance I have in mind. Particularly Ljubo Sirc, who was so tremendously important in raising new leaders and these people have brought in another generation and thus we still have reformers there.

Oana Sociu: I am a political sociologist not an economist and would like to address the issue that interests me the most, social relations. I found both the presentations extremely challenging and I think we should also take into consideration not only economic capital but also the social capital, which was only touched on: The networking between the individuals who are subject to transition and also the political capital. If we look at what happened in Central and Eastern Europe I would say we have quite a weak social capital, quite

strong political capital and mild economic capital. And that is why in comparing Eastern Europe with Africa and post-war Germany I had the feeling that both of you were somehow comparing oranges with apples. I think one should also take into consideration the effect that the reforms imposed from the top might have on the population these countries. I think there is a huge gap between the economic and political leaders on the one hand and society on the other. For instance what happened in my country, Romania, in the early 1990s, were people shouting in the streets "we are not selling our country to foreign investors" and "We work. We don't think". This illustrates a huge gap between society and its economic leaders.

I have two questions for Rado Pezdir: what exactly do you mean by old boy networks? My first thought is the recirculation of the former communist elites. By communist elites I would understand to be economic and political elites. Also, how do you see the impact of these in Slovenia now?

Rado Pezdir: The first answer is Red directors. Secondly, the impact: a great obstacle in Slovenia where we have two opposing interest groups: the first is the old boy networks and the second new interest groups that were born out of the fiscal policy. It is a great obstacle for transformation. First you have to abandon a command economy and that is the social agreement. Without abandoning it there is no way to move towards reform, as we have seen lately how strongly trade unions and farmers object to any kind of reforms. We must also get rid of the interest groups but this cannot happen unless the economy is liberalised and competition comes in.

John Moore: I would say economic growth. Using a model of economic growth in economics is due to changes in resources, technology and institutions, these three things. Resources are labour, human capital, physical capital, land – all existing resources together with the institutions. The point I am trying to make is that there is no single silver bullet that will solve this issue. It is a complex matter and it varies from one place to another. You cannot have one single solution.

One thing that has been on my mind is that we around this table are talking almost like central planners: We know what is right; what should be done; what people want and how they should get it; we are going to direct it the way we want it, whether or not they like it. The important thing seems to me is somehow to develop the set of circumstances that will enable people to choose what they want – to be free to choose.

Silvana Malle's point is quite important: the young people who can be educated and bring ideas to their societies; that will be important. Unfortunately it means that it will not happen overnight. It will not happen in five or ten years. It takes a long time.

On my travels the last two weeks in Eastern Europe I have heard people talking particularly about the reform of scientific institutions that the younger generation of scientists are keen to do. They are adapting ways consistent with better scientific practice. The older generation are reluctant and resistant, taking a long time to change. To change the whole of society takes even longer.

Joel Samy: I want to add to what John Moore has said: the importance of choice and not the temptation to ram something down people's throats. One of the intriguing things we that have seen in Eastern Europe is the evidence and experience of free market reforms, which are very radical compared to what is happening in other parts of the world. I was thinking of a conversation that Natasa Srdoc had a year ago with Milton Friedman on what could be done in Croatia: he said -- look at the evidences of the experiences of the other former communist countries. What he said is very profound, and sometimes we overlook the impact of free-market institutes in places like Slovakia, where there has been a transformation and the important role that free-market think tanks do play. The transformation of Eastern Europe in a little less than fifteen years is amazing indeed. Free market think tanks and its leaders have been working in the trenches of post-communist nations and the results are now showing up in places like the Baltics and even with Romania's tax reform and efforts to combat corruption.

In the case of Bosnia we have not seen good come from crisis. This may be an exception. One of the reasons that we have not seen similar transformation in comparison to other Eastern European nations is probably due to the recent wars and its role as colony of the UN. Over the last ten years, the international community has poured billions of dollars into a bottomless pit thus supporting and strengthening the corrupt officials in Bosnia.

Secondly, without a constitutional democracy (that which is respected), the lack of rule of law and protection of property rights, Bosnia has become an infinite UN colony. Is there greater economic freedom in Bosnia since the late 1990s?

In Croatia we see tremendous opposition to reform because of political inertia and corrupt officials standing in the way of reform. The rule of law and an independent judiciary is absent in Croatia. However, in Slovakia there has been remarkable transformation where a group of free market institutes got involved in a grassroots campaign and consistently relayed free market ideas. It took eight to ten years to transform a nation that was looked upon by Europe as the ugly duckling. We should look more thoroughly at what they did, which as I say was truly remarkable. They influenced universities and in particular invested in students, initiated a tax Freedom Day, educating individuals and working with the media. What these institutes did was remarkable.

Philip Booth: thank you all for the very interesting comments and I have three points to make which are all very pessimistic I am afraid. I think they take up nearly all of the issues which have been raised. The first and the easiest is related to Bernard's point on trade and which others have also mentioned. There is absolutely no question that the West and Japan should open its markets. Of course, it would make some difference to some countries in Africa, which are trying to promote development. But there is no magic solution there. You could take the population of India - and the population of India today is not so very different to that of the whole world when Britain began to develop. There are plenty of opportunities for India to develop even if it did not trade with any other country in the world at all – there are ample opportunities for comparative advantage within the country, if

they had liberal internal markets. Trade is not the main issue for such countries.

The second pessimistic point: I agree with Silvana Malle that the West should try to deal with pressing needs such as famine. I do not think there is much dispute there. The issue is development aid. Where development aid is channelled through genuinely voluntary bodies such as charities etc I have less objection to it. But it does worry me that it then leads to the politicisation of these charities. Certainly, we have seen this in the United Kingdom with some well known organisation. People believe they are acting as charities but they are not; you only have to look at their websites. Worst of all, is aid that is directed through governments. You may think that the worst that can happen is that it does no harm except that money is wasted. But in fact it bolsters their institutions, and as Peter Bauer pointed out, it redirects entrepreneurial activity away from the market and towards the political process. You do not have to go to Africa to see this happening. Just go to any British university where so many resources are allocated to administrative processes and the best people are drawn out of teaching and research in order to carry out these bureaucratic processes to attract resources, a normal human self interest response.

I am also slightly wary of Silvana's statement that countries will choose the institutions they want. I am not sure what that means either in a democratic context or one in which there is no democracy. It seems to me to be too easy a phrase to use, that a country will choose its own institutions.

The third point, is on a slightly more positive note, but sadly does not lead to any solutions. Several people brought up the question of entrepreneurship, and taking Bob Reilly's point further on the issues of the moral cultural environment of countries. I mean the wider moral perspective of the word here. Bob asked why all these African countries that were left with good constitutions did not develop. That is a good question, particularly when one thinks of countries like Canada, Australia, New Zealand, Singapore which were also colonised and left with constitutions and have developed.

Peter Bauer used to talk a lot about importance of the entrepreneurial spirit amongst the indigenous people within the country and also the moral-cultural background to develop these important institutions and ensure they were effective in enforcing contracts etc. If there is not a general culture of belief in property rights, contracts and so on it is extremely difficult for a government to impose this from above. I think wider moral-cultural belief in these things is important. It is difficult to impose solutions from outside and I think this has been proved in the World Bank's efforts to impose good policies by tying them to aid. I am not a great expert but apparently this only tended to work where there is a real desire for reform in the country itself. Related to this point I would say, "forget democracy", not altogether but as an absolute value in itself, and think more of tying to develop democratic institutions that favour property rights, private contract and the rule of law. I know that Will Hutt who wrote for the IEA years ago, said how differently South Africa would have developed if instead of bringing in a system of apartheid in 1948 it had simply brought in a property qualification to vote. Property loving society institutions

might well have evolved much more naturally and there would not have been overt discrimination against blacks and coloureds. This not only rewards entrepreneurship and the pursuit of property but also embeds democratic systems within their fundamental function which is the protection of property. How one does this in a world where all politicians seem to believe in absolute democracy, I do not know.

Rado Pezdir: Two things I would like to point out, the first is a very interesting point Krassen Stanchev mentioned: electors voting out government parties in central and Eastern Europe. It would be interesting to apply this kind of mechanism in Slovenia because even if it were possible nothing much would happen as our market attract interest groups and not individual voters who are flexible enough to support transformation. We are locked into this system and I am not sure how it will be unlocked.

Secondly, several people have mentioned that the circumstances in post war Germany were very different from Slovenia – comparing apples with oranges. It is an illustration of social science: it is always different like a benchmark of a certain amount of obstruction to observe which are the important forces and mechanisms. This is due to intellectual curiosity and because we wish to change things and to make good policy recommendations. So we examine how they formulated effective policies in Germany after the War and see if we can apply these here.

Ljubo Sirc: Thank you all very much I am most grateful to everyone who took part in the excellent discussion.

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Second Session
Spontaneous Entrepreneurship versus
the Insider “Privatisation” of State-Owned
Enterprises

Entrepreneurship under Communism
by Vladimír Benáček

The failures of the communists' economic management throughout Central and Eastern Europe resulted in a domino of political collapses unparalleled in human history. These coups, achieved so easily, were named “velvet revolutions”. Some political speculators even question whether the dismantling of communism was a genuine demise or rather an attempt at retrenchment by the communist masterminds. A massive apparatchik involvement in the privatisation in practically all transition countries suggests that more scrutiny of the process of new entrepreneurship in these countries deserves attention. Where could entrepreneurship in transition countries come from?

Before going into more detail let us start with an old joke as an outline — a joke that circulated in various national forums from Eastern Berlin to Vladivostok throughout the 1970s and 1980s.

Six miracles of communism:

- 1. All are employed — but no one works.*
- 2. No one works — but the output target is always fulfilled.*
- 3. Output target is always fulfilled — but there is nothing in the shops.*
- 4. There is nothing in the shops — but the people have everything.*
- 5. People have everything — but they all swear at the regime.*
- 6. All swear at the regime — but in elections they all vote for the communists.*

There may be a lot of exaggeration in this joke but its anecdotal wisdom also reveals that practising communism required a great deal of entrepreneurship for each “miracle”. But what kind of entrepreneurship could it be? Baumol, 1990, provides the best clue when he stressed that human entrepreneurial activities were omnipresent and could never be destroyed. The problem is in which alternative economic fields — productive, redistributive or destructive — and under what conditions the entrepreneurship is allocated in the given period. Baumol’s classification also allows distinguishing between the Marshallian-Schumpeterian productive entrepreneurship and its other orientations. The crucial role is then played by economic incentives and market institutions, which should be fine-tuned in order to enhance productive entrepreneurship and to divert it from redistributive, predatory or destructive ventures. Therefore, however bizarre the organisation of communist economies, some entrepreneurship even found its way there. We can distinguish its two roots: the capitalist and the socialist (communist) one.

The Central European and the Baltic countries, but to a lesser extent the other countries of the Soviet Empire, could still rely on the cultural principles that characterised their societies two or three generations ago. The legacy of capitalism and the memory of self-reliance were most useful in situations when the workers had to forage by moonlight and barter things for a livelihood. At the same time the mechanism of career building under communism was such that only a fraction of the productive human capital, such as technical skill, was necessary for a job at the nomenklatura level. So the entrepreneurial outsiders could satisfy their natural urge either in retail trafficking or in do-it-yourself household or fraternity tie-ups, such as house or car repairs, sports, arts, holidays, underground political dissent, etc. Their entrepreneurial skills were to a large extent frittered away by high transaction costs on the exchange side. Nevertheless, it was a valuable entrepreneurial training that could be most useful whenever small business practices would be liberalised. The legacy of capitalist entrepreneurship in communist countries was therefore spread asymmetrically throughout the social structure.

The legacy of socialist entrepreneurship was of different stock. It concerned the party bureaucrats who had to invent the most bizarre tricks in order to push through the unviable system of blind central command to achieve at least some sort of performance. If it were not for the common good, they would do it at least for their own “residual claimancy” to be satisfied. The Brezhnev style of corporate management introduced in early 1970s could not avoid innovation or flexibility, however absurd were both in their processes and outcomes. As an option, the management of enterprises could either take an inward orientation towards innovation and

efficiency⁵ or an outward orientation towards negotiations with the vertically superior bureaucracies. In the latter case the objective was to bargain for a softer plan for output or a higher quota on inputs.

With the widening possibilities for the official (and unofficial) accumulation of wealth, socialist millionaires have cropped up everywhere since the 1970s. If an apparatchik fulfilled the plan target and showed sufficient loyalty to the superiors, he/she was given a free hand to exercise power over resources, staff policy and bonus remuneration in the economic unit belonging to his/her respective rank in the hierarchy. On the equal horizontal level of bureaucratic subordination the apparatchik manager had powers to collude with other "partners" in order to form cartels, information asymmetries and political coalitions, which liquidated potential interference in the production, distribution or planning processes. In their relation to various superiors (on the level of state planning, district council supervision or party subordination) bureaucrats had a wide range of alternatives for negotiations and vertical collusions in order to strengthen their strategic standing.

The resulting socio-political antagonism caused by the different relationship to entrepreneurship can be identified with three social groups. Based on the study of Benacek, 1994, we will call them "marketeters", "nomenklatura" and "outsiders". The

⁵ Given the known lack of microeconomic fundamentals, as it came clear from the Hayek versus Lange-Lerner controversy, the management of efficiency could rely on some rudimentary principles only, such as the minimisation of queues, inputs of material and energy or imitation of products and processes used in market economies (Kornai, 1980).

following approximate list of activities can be made in order to distinguish between them:

(i) Marketeers: private farmers, repair workers, artisans, tradesmen; catering and hotel staff, cab drivers, foreign exchange touts, greengrocers, used car dealers; shop managers, shop assistants, stock keepers; popular entertainers, artists, top sportsmen; administrators of queues, bureaucrats issuing licences, certificates and permits; ringleaders of organised crime.

(ii) Nomenklatura: directors of companies, their deputies, heads of divisions or financially independent units, paid party apparatchiks, high-ranking bureaucrats at ministries, district and municipal councils.

(iii) Outsiders: people with low entrepreneurial aspirations active in the do-it-yourself activities; but also there were people with high moral and/or human capital, such as doctors, engineers, computer whiz kids or scientists whose potential of entrepreneurial skills could not be used under the communist system.

As an illustration of the size of such groups, we can use the data from the Czech survey of 1992. The pre-transition society in Czechoslovakia could be intuitively structured as 10–15% belonging to group (i), 4–8% to group (ii) and 77–86% remaining in group (iii). This had an impact on how the economy was split into the state, the private and the shadow sectors. Their sizes differed by countries. According to Janacek, 2000, the share of private sector on GDP in 1989 was 1.5% in Czechoslovakia, 8.5% in Eastern Germany, 14% in Hungary and 26% in Poland (mainly due to private farming). However, what mattered for the potential of

entrepreneurship were the extents of the shadow economy and autonomous managerial activities of nomenklatura. Although they can be hardly quantified, their presence and the crucial importance for the communist economies are undeniable. When the window-dressing of central planning and hierarchical subordination finally lost the institutional support in 1990, the enterprises and the economy hardly recognised any change at the beginning: the "shadow management systems" were already in control of the economy and ready for transition (Benacek, 1994 and 1995). However, the transition was tougher and different in its contents than anyone presumed.

Entrepreneurship in the Early Stages of Transition

It follows that it was the apparatchik management of the state monopolies and not the central planners who were in control of the official parts of the economy and who even gained more when Gorbachev's "glasnost" undermined the instruments of totalitarian coercion. Such national systems were ready for transition, once a strong external shock cracked the institutional braces in merely one country. There was a risk and uncertainty in individual cases but under the premise of a "velvet revolution" the nomenklatura could not expect to lose much as a group. A similar situation rested with the marketeers: they expected a better deal once their activities were liberalised. The outsiders group seemed to gain the least in immediate entrepreneurial advantages and their gains from the transition were originally associated with higher consumer choice and the introduction of democracy.

As the 15 years of transition later revealed, the small-scale entrepreneurial gains were favourable for the outsiders. In the long run they used their human capital, organisational skills and endurance for the majority of gains in the small businesses and self-employment. For example, in the Czech case 18% of all employees were registered as self-employed businesses by 1994. In 2003 that number increased to 28%⁶. These figures show a very high degree of entrepreneurial organisation in an international comparison. Also in other Central European and Baltic countries the rise of self-employed among the former outsiders was very high (Selowsky and Mitra et al., 2002) and comparable with the situation in traditional market societies.

The transition hit harshly the private sector that was already established under socialism. As pointed out by Winiecki, 2000, and Winiecki *et al.*, 2004, the emergence of new business opportunities after 1989 caused bankruptcies not only among the state firms but also among the old private businesses. The reliance on the shortage economy, the lack of discipline and entrepreneurial vision and the failure in restructuring caused shrinkage of the old private sector by 40–75%, while at the same time the new start-ups coming from the group of “outsiders” contested the markets. We can therefore come with a general hypothesis that the group of socialist “marketers” did not prove to have sufficient skills for an easy transition to the ranks of new entrepreneurs. The reason was a dramatic change in incentives and in the environment of businesses after the fall of the iron curtain. The incentives under communism induced the marketeers to

⁶ According to the Czech Statistical Office, Annual Yearbook, 1996 and 2004.

profit from the excess demand, black market prices and corrupt state bureaucracy; not a useful experience for functioning markets.

The most surprising was the transition of the nomenklatura to the ranks of entrepreneurs in enterprises with hired employees. In the Czech case, as in practically all post-communist countries of Europe and Asia, their betting on an easy deflection after the velvet revolutions proved correct. So it was at least in the early stages of transition. Benacek, 1994, p. 20–22, estimated the social structure of successful entrepreneurial transition in 1992. Nearly 16% of all nomenklatura succeeded in becoming owners of firms with employees. In the top ranks the transition rate was 29%. It implied that practically all the departures (forced or voluntary) of top nomenklatura from the state employment must have been directed to some sort of private businesses! The importance of insider domination in former state-owned firms was present in all transition countries (Djankov, 1999).

The Czech data also suggests that 73% of new entrepreneurs who were not self-employed were not associated with the nomenklatura because 44% came from the lower ranks of the communist bureaucracy and 29% came from the ranks of “outsiders”. This latter figure is highly disappointing. It demonstrates that only 0.8% of the outsiders managed to overcome the barrier of self-employment. This phenomenon can be explained only by presuming that there must have been other barriers (except managerial incompetence) precluding the outsiders from entrepreneurial entry after 1989: lack of wealth, lack of appropriate access to public property and lack of pull

from the bureaucracy or the crony network. For the nomenklatura the situation was the opposite.

The Explanation of the Selection Bias

The notion of “order” is one of the pivotal concepts in explaining the social development and organisation. According to Hayek, 1973, it was in the tradition of German philosophy to distinguish between the natural fundamentals, i.e. the intrinsic real contents of human aims and development that he called “Cosmos”, and the man-contrived infrastructure of the spontaneous order called “Taxis”, which reflects the aims (i.e. the interests) of specific social groups. Hayek claims that it is impossible to introduce a new viable order by force — by simply manipulating Taxis, irrespective of the state of Cosmos.

We can use Hayek’s reasoning and argue that the collapse of communism was a natural process of correction at the level of Cosmos because the communist organisation was an attempt at social engineering that brought the centrally planned societies to a universal economic breakdown. But that required an introduction of economic liberties, including the enforcement of property rights (as legal norms) and an opening-up of speedy privatisation (as an open auction), that both belonged to Taxis. However, the body of Taxis, as the pivotal instrument of the communist social organisation, could not be changed as quickly as the speed of privatisation would require.

Thus privatisation could not avoid being caught in the vicious circle of the impossible: introducing new Taxis before having

new Cosmos and developing new Cosmos before having new Taxis. Based on the mentioned typology of Hayek, the clashes between these two intertwined conditions for a balanced development, as seen at various angles of observation, are indicated in Table 1.

Table 1: The typology of the notion of “social order” and their contradicting duality

COSMOS	TAXIS
Exogenously given as	Endogenously given as
Personal liberty	Economic freedom
Economy	Politics
Technological progress	Organisation of enterprises
Free markets	Hierarchies of governance
Allocation of production	Institutions of power and
Informal rules, ethics, behavioural patterns, social capital and personal	Formal rules, formal networks, laws and judiciary

The right-hand side of the table is man-contrived and, except for rare revolutionary break-throughs, dependent on social negotiations and administrative clearing that are subject to a strong influence of inertia. Some observers speak in this context about path-dependency, embeddedness or hysteresis. We cannot say after 16 years of transition, even in the most successful transition countries of Central Europe that all features of the command economy have been eliminated. Their institutions are only gradually catching up with the advances in the development of their markets. In the early stages of transition, let us say in the first five years, the taxis

could not but move within the communist legislation, judiciary and formal networks. Privatisation was carried out in this opaque period.

Such a situation offered an environment that facilitated the past elite transiting to new entrenchments of economic power. Privatisation became the main channel for a trade-off between the former political and the new economic powers. In order to find workable analytical concepts, we will use two typologies of the evolution of the private sector: “privatisation from above” and “privatisation from below”.⁷ The former is based on turning existing state-owned enterprises into private hands, which crucially depends on the activism of the government and its hierarchical institutions. The alternative approach to the rise of the private sector leads through the establishment of the authentic (“generic”) private sector by the creation and expansion of “*de novo*” private firms. In the strategy “from below” the mainstream of activism comes from the grass roots of the economy, i.e. at the autonomous level of firms, where it is the entrepreneurial activism of their owners what matters. The difference between the two concepts rests in the difference between the *de iure* and the *de facto* meaning of “privatisation”. The parallels with the Hayekian notions of Cosmos and Taxis are crucial to their distinctiveness.

In contrast to the development of private ownership by evolution in the traditional market economies, private ownership in the initial transition period had to be created by a “privatisation shock” — i.e. by the privatisation from above. There, the initial selection of both the owners and the property

⁷ This typology was first applied by Gruszecki and Winiński, 1991, and later used by Benacek, 2001 and Winiński *et al.*, 2004.

privatised was subject to an “acquisition bias” that depended on how the selection techniques departed from the criteria of perfect market bidding that included free competition and access to information. For example, the administrative methods of privatisation had the following structure in the case of the Czech Republic (computed from the value of all productive assets held by the State in 1989):⁸

- a) retail auctions (0.7%), public tenders (1.3%), voucher privatisation by individuals (12%), restitution (11%), transfers to cooperatives (8%);
- b) voucher privatisation by investment funds (27%), transfer to municipalities (18%), direct sales to pre-determined buyers (4%), liquidation (2%), retained state ownership (16%).

The bias to non-competitive transfers or to methods where the insider position was strengthened, such as to privatization techniques concentrated in the group (b), was evident in other countries too, not only in Czechia (Benacek, 2001). On the other hand, privatisation from above is a one shot game subject to information asymmetry and no one could expect that its outcome would result in a sharp improvement of efficiency. For example, the objective of many new owners (consistent with their previous entrepreneurial experiences) could be acquiring debts and practising asset stripping for mere private consumption.

In addition, it could even be affirmed that the intransparent methods of bureaucratic privatisation strengthened the

⁸ According to the data of the Czech Statistical Office, 1998, and the Czech National Property Fund, 1997.

negative properties as “markets with lemons” (Akerloff, 1970) and the outcome could not escape adverse selection. As argued by Pejovich, 1994, or Loužek, 2005, the main objective of privatisation should be seen in creating the free market for institutions and incentives supporting property rights. Unfortunately, the privatisation in Central and Eastern Europe often failed in succeeding even in that goal because the new entrepreneurial elite found itself in a situation where it was more advantageous to postpone enforcement of property rights and to continue rent-seeking strategies.

As a result, the problems with governance and management at the state enterprise level contaminated also the privatised enterprises. The governments, instead of standing by the policies defending market discipline (e.g. hard budget constraint and debt reimbursement) and market sustainability (e.g. pro-investment climate, transparency of information and competition), over-protected old enterprises, levied high taxes on successful firms, built investment barriers and engaged in anti-competitive practices. We can therefore show in Table 2 how the contradictions inherited from the communist order, as described in Table 1, transformed into a bias in policy-making in the early stages of transition.

Table 2: The bias in policy-making when politics dominate over economics in the privatization stage of transition

ECONOMICS	POLITICS
Independent firms	State authority
Private property	(Semi-)Public property
Incentives “carrots”	Fiats “sticks”
Wealth creation	Wealth redistribution
Capital accumulation	Capital consumption
Market competition	Regulation
Profits and asset returns	High taxation and subsidies
Free trade	Restrained trade
Hard budget	Soft budget
Creditor-dominance	Debtor-dominance
Low transaction costs	High transaction costs

As administration-driven privatisation “from above” could not succeed in creating effective final owners, a new round (or even several additional rounds) of re-privatisations had to follow. The structure of new “capitalists”, many of who were former apparatchiks, was bound to be only transitory. There were too many agents who lacked incentives or capacities to help their principals in the accumulation of wealth. There were some principals who also lacked both and failed, but there were many others with good entrepreneurial potential who were not backed by institutions for the defence of their property rights. Granted the conditions that caused adverse selection of the new elite and the external shocks to their stability, the vested interests forced the new capitalist elite to

collude with the state bureaucracy in order to retain their position and defend their objectives. Free markets and competition became the most effective (and therefore most feared) instruments for revealing the non-tenability of their status. Thus the policies as a spin-off of privatisation “from above” and its non-authentic entrepreneurs acquired a strong bias towards regulation, restrained trade and soft budget legislation.

Once the early stages of transition were associated with the state-administered privatisation, bureaucratic policy-making, information asymmetry, adverse selection, moral hazard and institutions not in harmony with free markets, the most important capital for becoming an entrepreneur was the social network capital (Sik, 1993, Mateju, 1993). As further analysed by Bezemer, Dulleck, Frijters, 2003, the economic behaviour of entrepreneurs in transition cannot be explained without recourse to the concept of relational capital. Thus we should distinguish between the human capital, as the skill directly associated with market-related efficiency in decision-making, organisation and innovation, and the relational capital, as the skill associated with redistributive coalitions, bureaucracy and state capture that are negatively associated with the efficient functioning of markets.

The relational capital in the time of the fall of communism was highly concentrated in the communist nomenklatura network because hierarchies formed the core of both formal and informal channels of communist governance. The velvet revolutions, which relied on the power of free markets to administer the post-communist “governance clearing”, have not succeeded in dismantling the old relational capital and

replacing it by a new network of outsiders. Therefore, it was obvious that the apparatchiks and nomenklatura could retain or even strengthen their initial insider advantage and use it in their favour in the first round of privatisation.

Entrepreneurship in the Later Stages of Transition

We have mentioned in the previous chapters that the transition from communist socialism to capitalism was impeded by the inability⁹ to dismantle the previous institutional order in a sufficient speed, so that the spontaneous changes in the economy could not be supported by an equally progressing institutional setup. The clash of spontaneous development from “below” with its lagging institutional barriers was imminent. It took several years to undermine gradually the ensuing deadlock. Such a situation strengthened the comparative advantages of the nomenklatura for getting an easier access to the assets privatised by insider bureaucratic methods that deviated from the standards of competitive bidding under perfect information. As argued by Louzek, 2005, installing an ideal environment for transition was practically unachievable and both the governments and the economic agents must have accepted the solution of the second best. There were hardly any tractable alternatives that

⁹ We should even speak about the impossibility to attain a speedy institutional transition in a democratic environment because the imposition of democracy was generally a process with a higher priority than the introduction of property rights and privatisation. It was simply politically unacceptable to postpone democracy and commence with the revamping of the institutions supporting the private property build-up and with the elimination of relational capital that former nomenklatura used for their low-cost transition from the apparatchik “entrepreneurship” to the capitalist one.

would guarantee a Pareto-optimal improvement, as there were no alternatives without trade-offs and social clashes. The resulting information uncertainties and asymmetries also limited their ex-ante cost-benefit analyses.

The distribution of new ownership after the first wave of mass privatisation did not satisfy the condition of finding the final and most efficient owners. The obsession with privatisation resulted from the illusion of “windfall gains” led to a social myopia, which overlooked more productive alternatives of *de novo* enterprises, often representing a more creative entrepreneurial achievement. The crucial question of transition then remains: how the society is capable of launching processes after the initial “privatisation shock”, which would bring gradually a convergence to an optimal equilibrium in the ownership structure (Pejovich, 2004).

It should be stressed that this is a problem of installing institutions and incentives supporting entrepreneurship and wealth creation. It is not a task of direct government intervention with such processes but an inducement of the behaviour to rely more on markets and competition. What kind of conditions and processes were available that would bring about the task of convergence to a viable alternative? We will speak about five of such critical factors:

- Liberalisation of markets
- Rise of the *de-novo* sector
- Spontaneous enhancement of competition
- Lowering of transaction costs for contracts
- Rising hard budget constraints.

Liberalisation of markets advanced by introducing new laws that were market-friendly. The process of legislative changes was one of the most resistant to progress practically in all transition countries. In this respect the EU accession process played a highly positive role because it forced the accession countries to introduce some of the highly liberal parts of *acquis communautaire*, for example the competition, contestability and free trade policies and the Copenhagen criteria of competitiveness. The judiciary and law enforcement were the critical bottlenecks, which are recovering only very gradually. After 16 years of transition there is still much to be improved.

The rise of the *de novo* sector had two main channels: foreign and domestic. The penetration of foreign direct investors was not uniform in all countries. However, as the countries lagging behind recognised the advantages of FDI, their willingness to adjust laws and institutions to become more market-compatible was increasing. The development of indigenous entrepreneurship, concentrated mainly in the small and medium-sized enterprises, was as important as the former. In many transition countries the efficiency of this sector was even higher than the efficiency of the former large state-owned enterprises privatised by vouchers or employee or managerial buy-outs. Small and medium-sized enterprises and the FDI firms were also the creators of new jobs, which raised their moral standing in society.

The spontaneous enhancement of competition resulted from the two previous trends. Markets cannot be suppressed by government interference once the flow of information concerning opportunities is available, and the enterprise sector

is subject to free entry. It was of high importance that the competition from domestic *de novo* firms and enterprises from abroad were not eliminated by laws from entering the non-tradable sectors that were originally state monopolies (e.g. telecommunications, energy, transport, banking).

The lowering of transaction costs for contracts and for the transfer of ownership is best explained by the Coase theorem. Once the transaction costs of negotiations about property rights were decreasing, what was achieved by improved laws, judiciary and information flows, the role of negotiations about the compensation for negative externalities and the opportunity costs of the asset ownership gained on importance. The lowering of risks, uncertainties and the higher transparency of accounting and debt disbursement allowed an easier cost-benefit analysis, which speeded up the transfer of property to more efficient owners.

The rising hard budget constraints, caused mainly by improved banking, capital markets and the enforcement of property rights, replaced many negative externalities of dysfunctional institutions by new positive externalities, especially by changing the incentives and objectives. The availability of stocks of assets that could be stripped of their value was also sharply decreasing because such assets depreciated to even negative net worth, once the markets revealed the price of opportunities. The wave of bankruptcies, especially in the banking sector and former state-owned enterprises, diminished the strength of vested interests lobbying previously for incentives and institutions that were not market-compatible. Time was gradually moving the

pendulum towards reforms favouring the economics column of Table 2.

Given the development of the environment that followed the market requirements, the Central European and the Baltic countries (CEBCs) have turned gradually from laggards in growth to Europe's dynamic economies. Their catching-up with the level of less wealthy countries of the EU-15 is undisputable. Countries like Estonia or Slovakia became leaders in reforms in the EU-25 and the liberalisation of their economies brings a pressure for reforms to be implemented in other CEBCs or even in the leading countries of the EU-15. Even though there are still many impediments to free markets pending the dismantling or institutional changes to be introduced for liberalisation of markets in CEBCs, the indices of economic freedom have been improving recently. A marked progress can be observed in the efficiency of capital markets. Thus their previously hidden extra-market transactions lost the feature of information asymmetry, which raised the efficiency of capital assets substantially.

The role of the nomenklatura among entrepreneurs has been steadily declining since the end of the first wave of privatisation in CEBCs. The subsequent waves of secondary re-privatisations and bankruptcies favoured the young elite without any links to former communist networks. The importance of relational capital in entrepreneurship has been losing ground by being crowded out by the human capital.

Inefficiency dropped almost completely from the privatised enterprise sector. At present the main burden of dead-weight losses in GDP is concentrated in the expenditure side of the

state budgets. Their inefficient allocation to insufficiently restructured public services (defence, police, education, health care and public administration), whose functioning is in conflict with the market behaviour, is a burden that constraints directly the growth in approximately one quarter of the economy.¹⁰ It is in the expenditure side of state finance where introducing entrepreneurial techniques of management could bring radical gains in efficiency. On the other hand, the indirect inefficiency in public finance burdening the private sector is due to excessive taxation and excessive social and health insurance premiums. The potential gains in competitiveness of enterprises coming from the revenue side of the budget are also substantial and the recent radical fiscal reforms in some CEBCs will have to be followed by others.

Regulation, as the legacy of communist management, is a problem that impedes the spontaneous entrepreneurship throughout CEBCs. What matters in the formal rules is the relative regulation vis-à-vis the trading partners. Here the

¹⁰ There should be considered an even more sophisticated explanation of the inefficiency in the public sector: as the accounting for the value of government expenditure is based on the cost mark-up and on the quantity of “services” rendered, the official contribution of this sector to growth can be quite high. The problem is in the dissociation of expenditures from its utility. While the government can allocate a rising amount of funds to the public sector (e.g. due to rising indebtedness or proceeds from privatisation), there is no guarantee that also the utility to consumers will rise accordingly. High level of corruption in the government sector in the CEBCs and populist expenditures aimed at bribing the voters backfire and undermine the competitiveness in the private sector. They can even decrease the social utility of the total aggregate demand by means of opting for policies and allocations with high opportunity costs. Unfortunately the GDP accounting is not the best instrument for estimating such adverse spillovers of the public finance.

level of official explicit regulation became compatible with the EU-15 countries because of the acquisition of *acquis communautaire*. The implicit (hidden, informal) regulation represents a more serious impediment to entrepreneurship. Corruption, rent-seeking of bureaucrats, crime and the residuals of ethics originating from the communist past (e.g. the resignation of individuals on self-reliance and initiative) could drive the entrepreneurs to behavioural patterns, which hit the long-term competitiveness of the country. Its speed of development may thus get constrained as the entrepreneurs respond to such negative incentives.

We can conclude by pointing to the recent empirical evidence about growth. According to growth statistics, the advances in the healthy market-based sectors of the economies in CEBCs more than compensated for the under-performing sectors in the domain of public finance, whose entrepreneurs have not followed the incentives for restructuring. Such a tendency for hiding behind the second best (or even third best) strategies is spread in all bureaucracies. What matters is the trend. Here the recent reforms and the rising institutional competition among the CEBCs suggest that they are aware which track favours accelerated development. This is due to a growing importance markets have in decision-making, whose dominant agents are the authentic entrepreneurs. Much less can be ascribed to the government, the entrepreneurship of which has been unable to adjust to open market competition requirements.

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Third Session

Entrepreneurship in the Light of Human Rights and Judiciary

John Moore: Our topic concerns entrepreneurship, laws concerning property rights, but as I have quickly learned, it is one thing to have laws on the books and is quite another to enforce them. I think discussion of the distinction there could be interesting, and of course it raises the matter of the role of the judiciary. The questions of equality before the law, the questions of the rights of ownership - what that means, the use of control of enjoying the fruits of the production of property, the disposition of property, and the question of justice that came up yesterday could be of interest today. I know that we will find a lot of issues to talk about.

To lead off the discussion this morning we are privileged to have Peter Jambrek. He is Professor of Politics at the University of Ljubljana, and was a member of the Slovene Constitutional Court in the late 1990s, and a member of the European Court of Human Rights also in the late 1990s and the early part of this decade. He is a leader of the Assembly for the Republic in Slovenia, which is a non-party organisation and Dean of the Faculty of State and European Studies, a graduate school he established, I am delighted to turn the floor over to Peter Jambrek.

Entrepreneurship and the Law **by Peter Jambrek**

I will do my best to introduce simply some of the terms of Slovenia's constitutional law provisions on market economy. I am afraid I will not have time to go into specific case law and solutions that the constitutional court requires jurisdiction added to the constitutional provisions. It may be defined as a field in constitutional law to which some commentaries are tied to the constitutional law of the market economy and according to the commentary of the Slovenian Constitution of 1991. That law is regulated by Articles 33, 49, 74 and 60 of the Constitution. In a broader sense, three other Articles 67, 68 and 69 should also be included to encompass the whole of this field of constitutional law. The European Convention of Human Rights is complementary to the Slovenian Constitution and in respect of the market economy, Article 1, of Protocol 1 is the most relevant. The main Slovenian Constitutional provisions of the free market economy may be found in Article 74 which guarantees free enterprise. Free enterprise is guaranteed, by this Article, and the establishment of businesses shall be regulated by statute; that any business activity in conflict with the public interest may not be pursued; restrictive trading practices and other practices restricting free competition as specified by statute are forbidden.

This article is in the part of the constitution on 'Social and Economic Relations'. However, Slovenian legal doctrine and jurisprudence of the constitutional court alike, interpret provisions of this article 74 as *rights*. Rights, human rights, but also rights of legal persons, legal and natural persons. Not

only these but also other provisions listed under social and economic relationships that could be considered as problematic statements directing possible government policies in Slovenia.

Therefore, the right to free enterprise in Slovenia, and the right to free competition maybe considered as negative and also positive rights. They protect the legal and natural persons against interference and limitation by the state to the right of free competition and free enterprise. But they should also be considered as positive rights requiring government action to implement them fully.

I should add that a constitutional clause on free enterprise and free competition is rare and exceptional in comparative constitutional law. In Slovenia it was added when the constitution was drafted in 1990-91 because there was no tradition or experience of free enterprise and free competition in a market economy during communist rule from 1945 until 1990. Therefore, it may be considered as appropriate, at least on a normative declaratory level, that the Slovenian Constitution from its concept included these provisions on the free market economy as well as constitutional rights.

Three other constitutional provisions complement the central free enterprise clause. These are, as I mentioned before, provisions of Articles 33, 49 and 60. Article 33 protects the right to own and to inherit property; it is a classic constitutional provision. Article 49 guarantees the freedom of work and freedom to choose his/her employment, and it prohibits any unjust discrimination in work opportunities. Article 60 contains guarantees for intellectual property rights.

Copyright and other rights flowing from artistic, scientific, research and innovative endeavours shall be guaranteed.

In a broader sense, additional and quite important constitutional provisions regulate free market activities in Slovenia. These are articles on ownership of property, 67, 68 and 69. They also relate to the manner in which property may be inherited. Article 67 provides the following: ‘the manner in which property is acquired and enjoyed shall be regulated by statute so as to ensure the economic, social and environmental benefit of such property’. These provisions resemble provisions of the European Convention of Human Rights, which I will mention.

Article 68 regulates property rights of foreigners in Slovenia. Before 2003, that is, before Slovenia’s entry to full European Union Membership, Slovenian statutes could only determine conditions under which land could be acquired in the country by foreigners. The Constitutional amendment of 2003, added in this respect the international treaty ratified by the parliament. The original protected clause, in terms of Slovenian ownership of property, was broadened so as to fall in line with the European Union norms. The same amendment of 2003 also abolished the former provisions of 1991, whereby foreigners could not acquire title to land, except by inheritance in circumstances where reciprocity of such rights of acquisition could be recognised. That provision was nullified, abolished, by the new amendment of 2003 following European Union membership.

Article 69 of the Slovenian Constitution regulates compulsory acquisition of property. Accordingly land and property are

fixed to land, may be compulsorily acquired or ownership thereof may be limited by the State in the public interest and subject to a right to such compensation in kind or monetary compensation from the state, as shall be determined by the statute.

Again, this is a provision which is similar, but more specific, to the European Convention of Human Rights, Article 1 of Protocol 1, where compensation is implied in the phrase 'general principles of international law' according to which compulsory confiscation by the state must be respected. The European Commission of Human Rights is considered to be above a Slovenian statute, but below the Slovenian Constitution, it is somewhere in between. The Constitutional Court considers the constitutional clauses and the ECHR clauses as complementary and, in its case law, regularly takes both into consideration and compares jurisprudence of the European Court of Human Rights in Strasbourg with its own jurisprudence.

Article 1 of Protocol 1 is directly applicable in Slovenia as are Human Rights provisions of the Slovenian Constitution itself. The first part of Article 1 of Protocol 1 is therefore an integral part of the Slovenian domestic law, it reads: 'that every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to conditions provided for by law and by the general principles of international law. It is a matter of dispute however and scholars and judges in Slovenia do not agree on the exact relationship between this ECHR provision and the domestic constitutional law. An interesting exchange has evolved in

this respect and it was also discussed and argued before the Constitutional Court, triggered by the Slovenian de-nationalisation legislation. The Slovenian Constitutional Court, during the 1990s adjudicated cases on privatisation and de-nationalisation with respect to the Slovenian constitutional clauses. However the outcome of the case laws in the Slovenian Constitutional Court is uncertain in view of the case law of the Strasbourg Court. Our colleague Dr. Sirc is probably able to tell us more. It may be that Slovenian de-nationalisation, privatisation cases brought to the Strasbourg Court may be reversed or another legal doctrine about the Slovenian de-nationalisation court practice may stem from the ensuing Strasbourg case law.

I am aware that Slovenian constitutional law on free market economy is encompassing. It provides for classic rights and more, but unfortunately I would assume, and I am personally convinced, that Slovenian practice in spontaneous entrepreneurship differs remarkably from the fine constitutional provisions and that is where our discussion begins.

John Moore: Thank you very much Professor Jambrek for that very comprehensive, and for me at least, informative background on Slovenian law in this area, and I think there are many issues that we may wish to discuss.

Let me just mention a couple of things that occurred to me as I was listening. The six main provisions that you mention dealing with property sound very good, very comprehensive, very consistent, I think, with what most of us would like to see in the way of property law. Of course the question is

always how these provisions work in practice and there is the old saying ‘the devil is in the detail’, and that is certainly true in the United States. Our constitution has been tweaked, and twisted, and contorted and, some would say, revised over the years in ways that make the original wording seem a little bit remote and somewhat disconnected with the intentions of the people who wrote it. But in any case I think this would be a very good subject to explore, that is the question of how these provisions are actually implemented, what is the experience of how it relates to what people actually do, the formation of enterprises, the protection of the property rights of individuals. You mentioned Article 69: the question of compulsory acquisition of property. This is very much like the rule of eminent domain in the United States which has been the subject of great controversy these last two or three months, with this infamous case of *Kelo v City of New London, Connecticut*. In the case, the city used its power of eminent domain to take the property of an owner in order to build a shopping centre and other developments on the site. The principal rationale was that tax revenues would be higher as a result. Previously, the power of eminent domain had been restricted to matters of public convenience, such as new roads. In this case, the power was extended to economic benefits to the local government. The case went to the U.S. Supreme Court and the city prevailed, to the dismay of those who favour limited government.

So things of that sort are very interesting for us to discuss. Quite appropriately the discussion that you introduced here was focussed on Slovenia. We have people here from a number of countries in the region, and it would be interesting to have commentary on similar provisions elsewhere to the

extent that that could be done here. You mentioned almost in passing the question of the European Union law, and I think there is the possibility for some interesting discussion of how the Slovenian Constitutional provisions and the provisions of the European Human Rights Law and the European Union itself may conflict or be inconsistent with one another. Then there is this question of the overlapping jurisdictions of courts, to which you referred at the end of your talk.

Krassen Stanchev: I was a member of the Constitutional Assembly of Bulgaria 1990-1991; chairman of another committee and member of Constitutional Committee, and for all these reasons I was following constitution making in all the countries in the region, from Russia to Central Europe. And I have a couple of questions on issues I did not understand and I still have some doubts. First, you mentioned the article which basically bans foreigners from buying land or acquiring land ownership provided it is owned by inheritance and so on and so forth. Most of the countries in the region have the provisional arrangements, the provisions read exactly the same, also the same wording until the last constitutional reforms on the eve of EU membership. Then, they passed provisional arrangements with the EU to keep a ban on foreigners' ownership of land for a period of seven years after the EU entry, until 2011. It was up to the countries, including Bulgaria, to amend their provisions lifting the ban before 2011, in Bulgaria – before 2014. There was opposition to prohibiting foreign ownership of land in 1991, but this opposition weakened in the seven year transitory period. There was a constitutional amendment in Bulgaria earlier this year, advocating the right of foreigners to buy land. Was there an attempt to have a different understanding

of those issues when the Slovene constitution was being discussed? Then there are changes and that is what is interesting because, it was up to other countries including Bulgaria to amend their provisions. Was there opposition to that article in 1991 which basically advocated the right of foreigners buying land. Was there an attempt to have a different understanding of that issue of the constitution?

My second question is linked to the constitutional provisions on how the government works. A few year ago, perhaps in 2000, I worked on a comparison of government machinery and property right provisions in a number of new Europe constitutions. There was a previous paper on similar issues by Joze Mencinger, in 1995 I think, on freedom of enterprise provisions; if I recall correctly the article was published in *East European Constitutional Review*. I was trying to compare the provisions you are speaking of today, and I was puzzled by the formula of the Slovenian constitution which says that the business that contravenes public interest should not be pursued or something similar. So the question is, how does it work? That means the registration of business is presumably controlled, and you record all the registrations at the court. Because in English, as you read it, it presupposes a preliminary control. And last but not least, the data on the constitution contains an intrinsic problem on the practice of the European Court of Justice. One of the cases which is typical is that of 1999, Deutsche Telecom against Schroeder. The idea was that Deutsche Telecom before it can sell off some of its shares through the stock exchange, wanted to restructure, with the prospect of increasing efficiency and the price, respectively. Since it was a public company, the chancellor did not allow the company to restructure.

However, the European Court of Justice decided that Mr Schroeder had the right of banning as a principal of DT. The European Court of Justice an enterprise to perform according to some sort of market logic. So, I am actually asking, if you were paying attention to these issues could you comment on them, please, and how they work in Slovenia?

Bernard Brscic: It is depicted how the constitution is a paradigm of a liberal constitution but the problem is it goes far beyond the Lockian sense of protecting life, liberty and property. You have mentioned that there are not only classical ones that are ensured by the articles of the new constitution but it goes far beyond that in a sense that there is much more attention to positive rights than the negative rights. And you have not mentioned one article that states that Slovenia is a welfare state, which is basically a total contradiction with protecting the negative rights that in my view the constitution should protect. I suppose the problem behind the faults of constitutions was a question between the two concepts of liberty, the positive and the negative. Also that the constitution gives too much power to the government in order to provide certain social rights yet are forcing contradiction with property rights.

You also mentioned the article defining the social context of property. This is a kind of socialist perception of property, that property is accepted as long as it provides social benefits. We should also consider the fact that the judiciary in a country like Slovenia is still permeated with ex-communists, and we talked yesterday about red directors, the problem in Slovenia is that we also have red judges. A former chairman of the communist party is still serving as a Constitutional

Court Judge. So the law and the books protect certain rights, but the problem is we still have the rule of men not the rule of law. Why after 15 years of independence and abolishing communism, do we still have this problem with the lack of rule of law. And my answer is that it was in the interest of certain political elites that nothing has been done, or not much, in introducing the rule of law. In fact one of the most important concerns in Slovenia's transitional record that we do not have a functioning rule of law. Instead we have a perverted welfare state as a kind of compensation because the state fails to provide protection of property rights and must give something to the electorate in a form of redistribution.

Rado Pezdir: Naturally there is a contradiction with what we see happens and what the constitution should provide, and in my opinion it does not provide a framework for the free market. Perhaps it is treated as a joke by policy makers because we actually instead of market mechanism have social agreements and collective bargaining. This is not in line with free markets and basically this is contradicted by our constitution, which should build a framework for it but in reality nobody does. Is the constitution not working, or are policy makers not taking it seriously because it is not a free market, but a social agreement and collective bargaining.

Vladimir Benacek: I cannot comment on the Slovenian case but my comments may be of interest generally. The Czech experience after 15 years of troubles and strife in transition whilst the legal and judiciary impediments to competitiveness, entrepreneurship and those are extreme and the cause was the legal education that was antiquated, heavily pro-communist with entrenched interest. Three years ago I worked out a

grand plan that would abolish existing law faculties and establish new ones. I am of course speaking about commercial law not general law. The curriculum would be led by law and economics so everyone would be well educated in law and economics. Mathematics would also be very important and we received the personal support of President Vaclav Klaus. Whenever we have shown this document to anyone the result has been panic, absolute panic. Everything was criticised and there were personal attacks, so it only shows that the entrenched interests are enormous. Finally we said that we would not abolish the faculties but would somehow try to reinvent the wheel; even that was impossible. This is my first comment, that this is something extremely important and it seems that is leading to inefficiency in this field. As I mentioned, law and economics, are important because they offer normative approaches. It is a sort of logic which is derived from efficiency of contracts, from entry and exit costs, competitiveness criteria, transaction costs minimisation, and this is exactly what I think is lacking in the existing laws, because existing laws follow in the better case some EU article; it follows advanced countries with a long history of reallocation experience.

I think transition countries should be more flexible than traditional advanced countries. We have certain specificity in this speedy reallocation of resources, so it is speedy entry but also speedy exit, and speedy exit may be more important than the entry, because in transition we make many mistakes. The problem, for example, can be over entry, and if the laws for entry are quite flexible there are many entrants and all of them could collapse and become bankrupt because somehow they are not coordinated, so there is a risk of over-entry. And the

procedures should allow exit without too many costs, so if you make that mistake, there should be some way that you can recoup your costs. I think all these things are heavily underestimated and unresolved in the existing laws, not only in my country but also in others – Hungary, Poland. We are not flexible enough, and the law of economics is unknown to our own lawyers.

John Moore: I just wanted to make one observation about what Vladimir just said and that is the reducing the costs of exit. That is a very interesting point, the observation is that if, to the extent that the costs of exit are changed, then of course you change the decision calculus for someone who is going to undertake a new enterprise, to the extent that the costs of exit are reduced it means that people will accept more risk up front. That may be a desirable thing, but it seems clear it would have that effect, it would change the calculus in some way.

Silvana Malle: I am interested to know more about the judicial debate in Slovenia on Article 1 of the European Convention and that it is directly applicable here, and you said it is a judicial debate, as I understood, and I would like to understand the two sides, what is debated. The second issue is that many of the Constitution's articles sound pretty similar to what we find in the Italian constitution. In our country it is important to know the secondary legislation, when you have questions on property rights, you do not address the question directly to the Supreme Court, you have normal justice courts because you have a commercial code. So how do these articles reflect the similar commercial codes? Is there contradiction or not between the primary, the constitutional

provisions, and the commercial codes? And thirdly, following the issue that Bernard is contesting the definition of Slovenia's welfare state, he was seeing contradiction between a number of other articles. In this context is there a discussion on whether this article in particular is what we call in Italy a problematic article: really an empty one, or a discrete article? In Italy, when we approved the constitution after the War, there was strong debate because the first article declares that the people have right to employment, the people have right to housing, what does this mean? In the end it meant nothing, because there was no secondary legislation, so this question that Slovenia is a welfare state, does this have an reflection on secondary legislation?

Oana Sociu: My question is related to the Romanian story. You said that in the Slovenian constitution, free enterprise is guaranteed and I am interested in the phrasing of this article, because later on you mentioned property rights of foreigners were only protected, not guaranteed. This is what happened in Romania with all the property. So we drafted a constitution in 1991, and agreed regionally, but after it was drafted by the parliament it was supposed to be approved by the whole population through a referendum. This is one of the reasons why I did not vote for this constitution because property rights were just protected and not guaranteed; eventually they changed it – in 2003 I think. And I think this is important when listening to Bernard say exactly what happens in Slovenia with the “Red” Constitutional Court also happens in Romania due to this constitution Although it was amended in 2003, we still have the same problem. So, it seems like an enormous difference but I think the protection and guaranteeing of property rights is really important.

Rasto Ovin: Thank you very much for your invitation to a very interesting meeting. It is not easy to contribute to very good discussion, which has developed especially from an economist's point of view. However, I will try to contribute some facts explaining the present situation in Slovenia. We are a small, homogeneous community, which from the North's perspective may be exposed to the risk of being resistant to any outside influence. This goes together in our case with a permanent aversion to anonymous mechanisms such as market, prices, but also discriminates against rule of law. In real life it seems that personal contacts and experience may be quite advantageous even when a legal procedure is to take place. Here the juridical system may disregard the importance of the public interest and external effects on one side and individual interests of networking persons on the other and act in the latter's favour.

When talking about the development of legislation in transition countries I believe we should not omit the question, Can the old European Union be our teacher in preparing an institutional setting for a market economy? One could doubt it. It is surely known to all, that at the present time in the EU we have been seeking the co-habitation of both juridical systems: the Anglo-Saxon judicial system and the typical European continental system. It has shown that the continental system is no more capable of handling dynamic developments in capital movements and transformations. Here the idea of the *Societa Europea* should bridge the gap between both systems, now a source of deteriorating competitiveness of the EU. Returning to Slovenia, we must consider that we find ourselves in the twilight of both juridical

systems: that we inherited from the former system and which can only be abused, and the one that the EU is attempting to change.

Andrzej Brzeski: The EU constitution as we know was rejected, but there is a body of law that has provisions which either clash or somehow maybe perhaps are not taken up in the Slovenian constitution: which courts have competence and which law has priority in application. I have been thinking about people who are fighting for various causes in Slovenian courts, or in Polish courts for that matter, and obviously if those countries are members of the EU and the EU has clear cut laws with respect to those cases, you would expect that as members of the EU they would have to conform with the EU law.

Natasa Srdoc: My question is how do we prevent abuse of property rights and rule of law in the recent examples of Kellogg vs. New London, Eminent Domain and also which happens very often in Croatia and I believe in Slovenia, even in Italy the UK and the USA, whereby the regular takers are actually declined and the permission is given in our constitution prosecution, so there is a public use and compensation, just compensation when the government takes the land of an owner. But what about zoning and proclaiming green areas, so the owner loses the whole market value of the property and there is no compensation whatsoever. It is very arbitrary and there is no compensation so in practice there is full abuse of property rights and rule of law. Is there a mechanism to define them properly in the constitution, so that these cases do not arise, or if they do happen, is there a law in

the constitution as the final stage that it is directly reversed, and the owner has the right to a just compensation?

And the second question is after the constitution was passed, the law of denationalisation passed before the law of privatisation, and how many cases have been resolved. How much of restitution and John might already have said this, so how much confiscated land and real estate has been returned to previous owners, and how many of state owned companies, of state owned real estate have been privatised?

John Moore: The interesting thing about the Kellog decision of the Supreme Court was the outrage that it provoked all over the country. It was amazing, I guess it should not have been amazing but it in some sense was. I do not know how many states introduced legislation immediately to prevent this from happening at the state level but it was a large number. And one question that could be asked about that, is whether anything like that has happened in cases here or elsewhere in the region where the state has used a provision like Article 69 to take property for public benefit and if there has been any such a case and if so what the public reaction has been to it. The other question I want to ask is this, in the US when this Kellog case was going through the courts the Institute for Justice, which is a non-government organisation, non-profit in the US, was the principle attorney for Kellog. They lost the case but they pursued it all the way through the Supreme Court and then they have been following it up since. I wonder if any organisations like that exist here, or throughout the region, that would be supportive of individuals who feel that they have had property wrongly seized from them. That is just a question.

Lubos Makuska: Just a few thoughts on what has been said so far. Well first of all, as far as constitutions are concerned, Slovakia probably has a constitution very similar to those of other post-communist countries, so we cannot talk about the constitution that recognises financial or economical rights. Constitutions in post-communist countries cared more about positive rights of third generation, mostly because the creators of these constitutions were former communists and could not conceal their background. Therefore, I would say the first version of Slovak constitution was a transitional constitution rather than a constitution of a free and democratic state. There were many positive third generation rights guaranteeing right for work, employment, education etc. The only limit for the exploitation of these rights was the condition of the Slovak economy.

Also, I find it very disturbing, that while the Slovak Constitution gradually become a constitution of a liberal, democratic state, the evolution of such documents in Europe (that is the European Union) is heading in the opposite direction. The Charter of Human Rights that was attached to the proposed Constitution for Europe is only the latest example. I do consider this Charter as being very dangerous because when approved it would implicitly apply to every member country without considering the specifics of each country. Also, considering the resolutions of European Court of Justice which in many cases expands the powers of the European Union, I think that after a while it really would not matter which rights you do or do not guarantee in your own constitution because the Charter would be applicable in every member country.

As far as the role of ex-communists in a judiciary bodies is concerned. For example, in Slovakia it was the case where a lot of ex-communists were either, as I said before, participating in a creation process of the constitution or/and are in the judiciary or other law bodies. Unfortunately, Slovakia was unable to dismiss all the communist judges, simply because there was no one else. In Germany, for example, after the unification of West and East Germany, they dismissed almost all the judges from East Germany and transplanted those from West Germany, because they had the luxury of having judges who were not former Stasi agents or of communist party members. The conclusion is that Slovakia was in a unfortunate situation where there simply had to be some kind of judges and unfortunately many were members or former members of the communist party.

John Moore: It is a very interesting point you made about the situation in Germany with the ‘red’ judges, I wonder if their jurisprudence has been better than that in Hungary.

Peter Jambrek: There were many questions which were not about the commentary, which added to the understanding of the topic in general. Also a number of questions overlap. They address the same issue from another angle so I will try to answer some of the questions together.

In terms of land ownership, I am aware that across the new democracies after the fall of iron border or curtain, whatever you call it, there was an awareness that those poor and impoverished countries could be subject to a large scale acquisition of land by foreigners, immediately after gaining independence from communist rule, and in Slovenia

independence from Yugoslavia and so forth. That is why in Slovenia, as elsewhere in many countries, we wrote a firm, straight forward constitutional clause prohibiting foreigners from acquiring land when the would-be buyers came from a country where there is no reciprocity established by international treaty.

I was a member of a group which drafted the constitution in August 1990. We were a close group of nine which met for a couple of weeks in a hotel outside Ljubljana, so we were free from any outside pressure. We wrote the draft in isolation actually, whether it was a splendid or not it was certainly isolation. So among ourselves we had different views on the scale of the danger which may be posed to the new country from outside, from foreigners jumping on our land, trying to acquire everything that is available. However, when the negotiations with the European Union on Slovenia's membership began there were pressures, though not from the inside. I think there was a national consensus in this nationalistic, patriotic feeling of trying to preserve sovereignty by retaining land, property in the hands of ethnic nationals. So when the negotiations began there were very severe pressures from our neighbours, Austrians and Italians to liberalise these restrictive clauses. Actually the Italians succeeded even before membership. We had to allow Italian citizens in particular to enter the property market in Slovenia. Then before entry in 2003, these restrictive clauses were abolished entirely, so nowadays a foreigner can legally acquire land in Slovenia. What I am driving at is, that those initial fears were to a large extent ungrounded. There was no major campaign of foreign acquisitions, no mass demand to buy land. Slovenian land is very expensive, and maybe even

not that interesting to foreigners, so it seems that they were not waiting for liberalisation to buy up the country. I think we are quite satisfied having liberalised the constitutional and statutory provisions and still able to control in a way this precious kind of ownership.

As for the welfare state, Article 2 of the Slovenian Constitution simply states that Slovenia is governed by rule of law and is a social state. I had the privilege of serving on the Constitutional Court for eight years, and it is actually the Constitutional Court which gives substance to the Constitution provisions. It interprets them, it applies them, and the case law of the Constitutional Court is the leading dynamic of the Constitution. We were appointed constitutional judges in 1990 and we served until 1998, and this first generation of constitutional judges defined the functioning of the Constitution. The case Law is now nicely summarised in a large volume of 1500 pages and is a commentary of the case law of the Constitutional Court. I would add that the Constitutional Court, in directing the interpretation of the Constitution, took very seriously the principle of the Rule of Law and did not take seriously the provision on the social side. As a matter of fact, it is a very meagre jurisdiction on the principle of social state, almost none at all.

There is extensive case law on the rule of law principle, which defines the rights and responsibilities of subjects to the Constitution. The rule of law was used as a very important instrument in the hands of the Constitutional Court to resolve cases in a way which was consistent with the comparative constitutional case law, in Germany, Austria, and elsewhere in

Europe. The Slovenian Constitutional Court found a number of implied principles within the rule of law principle, and even when the social state principles were involved the Constitutional Court rarely tried to relate them to the explicit social state principle, instead basing its judgement on the rule of law principle. For example, there was a case when there were a number of citizens complaining that a new law in Slovenia diminished the pension rights of retired persons. And here the Constitutional Court adjudicated in a positive way, relying on the principle of confidence in law and the restrictive interpretation of the traditional retroactivity of a law, which we defined as being implied in the rule of law. We said something like, a citizen of Slovenia has the right to expect the legal system to be stable over time, that it does not change arbitrarily in a short time and thereby does not diminish the acquired rights, like pension rights, which the person working throughout his life could legitimately expect not to be changed suddenly and radically. We said the pension law has to be changed by the legislative body so that it would provide for a reform of pension law over a longer time, and that the reforms would not abrogate the acquired rights of the citizens to an extent that would be beyond legitimate expectations. However we found this social state principle implied in the rule of law principle, not in the social state. Basically, you have to look at the jurisprudence of the Constitutional Court and see how it is interpreted there.

Now the related question was as to the liberal character of the Slovenian Constitution. From the constitutional law point of view, not only that the Constitutional Court was bound by the European Convention on Human Rights, and by the constitution, but also we were bound over time. The

Constitutional Court is bound just so now, by the principle of corporationalilty and by the proper balance between the property rights and public aims, which must be respected when a legitimate right of the state to limit property rights is pursued. Here I should mention the second part of Article 1 of the first Protocol of European Convention which reads that the proceeding provisions on the peaceful enjoyments of possessions are added by the provision that the above provision may not impair the right of the state; the state has the right to enforce such laws as it deems necessary to control the use of property in accordance with the general interest. So that is the European provision and again it depends on the courts how they interpret and apply and implement this general provision, but in principle the state may interfere and limit the property rights whenever it pursues its legitimate aim.

The Slovenian Constitution explicitly defines such legitimate aim, in particular Article 67 which reads that the Slovenian state may regulate by statute the manner in which property is acquired and enjoyed, so as to ensure it is not general interest but specifically economic, social and environmental interests of such properties. So whenever an ecological issue, or a social concern arises, then the state by the constitution may limit and interfere with the property rights. There is a basis for Constitutional and other courts adjudication on the balance between them, and we just have to look at the jurisprudence of the court to see whether in Slovenia's case the balance is tipping towards the free liberal interpretation of the property rights or whether it is tipping towards a socialist one; but that is a matter of practice, not of the Constitution. The Constitution allows for almost any kind of interpretation, a

very restrictive one or a very socialist one. It depends on who is the judge and what is the majority in the court.

Natasa Srdoc: That is a rule of man then, not a rule of law. In rule of law the rules imply that they affect anybody in the same way. The rule of man is when, depending on who is in power, he is going to say this is going to be done this way or that.

Peter Jambreč: I disagree. The Constitutional Court decisions are *ergo omnes* decisions, and affect everybody and are on the level of a general norm, a Constitutional Court decision in its effect may be compared to a statute. So it is not arbitrary that the decisions are made in a procedural way, applying tests of various kinds, which the courts across Europe have invented and are applying. In this sense it is not arbitrary. And the case law of the court are consistent, it must be consistent, if it is not then the equality clause is violated and may be applied by anyone. I am not arguing that the Constitutional Court of Slovenia is right or wrong, it is just that it is set a certain course which must be understood, in practice it depends how in summary to what degree Slovenia is still a socialist economy and to what degree it is a liberal market economy. Now the Slovenian Constitutional Court may say, to answer the question, the Constitution is such I would not consider it socialist or liberal, it is short and straightforward, and allows for a balanced judgment of the law from the Constitutional Court.

The Constitutional Court in its first term, eight years during the 90s, in my opinion was a liberal court. Throughout this decade it was involved in severe conflicts with incumbent

governments. Incumbent governments actually all belonged to something, had some kind of vision which the Slovenians would call continuity. Now, continuity is a label that was used for practices, parties, programmes as a disguise for the practices, programmes of the communists before 1990. So the continuity is an effectual course which according to different interpretations prevailed in Slovenia in the decade following 1990. Well those who were in power then would label themselves and perceive themselves as true democrats, standing for human rights and the market economy and would be extremely annoyed by someone calling them the continuation of the communists, of the communist parties. On the other hand there would be numerous examples, indicators which proved the opposite. So what I am trying to say is that we had during the 1990s a court which in terms of its personal structure was symbolising a rupture with the past and we had a government which could be symbolically for a least 12 years a continuation of the past. But it is a factual question and my personal opinion should not be taken as the final proof of anything. My Slovenian colleagues should help me to resolve this question. So that is a partial answer to the question of whether Slovenia is still a socialist or a liberal constitutional state. But after 1998, the first generation of the Constitutional Court members term ended and from 1998 on, we had another structure of the court. Again that is my personal opinion. The Slovenian Court is a packed court in terms of the Supreme Court of United States There are nine judges, eight to one, eight continuity, one who is still left from the 1990s. That is life. We may dispute it, and maybe the advantages of Slovenia in terms of the constitutional interpretation is that the main course of constitutional jurisprudence was set in the first eight years, and it is very

difficult for any followers of a firm case law to change it radically. I think, even a packed court of eight to one could not change much or almost nothing at all, other than a few details, from the previous generation of judges.

As to this distinction between the case law of the European Court of Human Rights and the Constitutional Court, and legislative practice, in Slovenia as to the return of property compulsorily acquired by the communist state from 1949 until 1952 – the revolutionary takeover. There is a clear distinction: the law on denationalisation which was enacted in the early 1990s allowed for the return of property to their original owners, if the property was taken by the communist state after the revolutionary takeover of the government. The denationalisation law however, allowed dispossessed owners to act as applicants for the return of the property. The new law did not define them as owners; the law did not return the ownership rights, it only gave them the status of applicant in a denationalisation administrative procedure. Ljubo Sirc could apply for the return of his property, depending on the positive outcome of this administrative procedure against which there was also a judicial remedy. Now, that is different from the practice of the European Convention in a European Court in Strasbourg. There, someone is invited to initiate court proceedings for a just compensation, a call for the return of the property, and it may be that the European Court procedure would fulfil the interest of the Slovenian denationalisation applicants to the fuller degree than the Slovenian standards and courts did until now. The denationalisation law was implemented throughout the 1990s, and according to some estimates, implemented up to some 80-90%. So 10-20% of cases of people who owned private property are still

unresolved, 10 years after implementation of the law. That was one of the largest so-called transition struggles in Slovenia, in terms of legal battles and political conflicts. There were two forces; the political, legal and economic forces of those who tried to hinder the return of the property, and those who tried to respect to the fullest degree the human rights of those deprived.

Krassen Stanchev: The need for restitution law is understood as real estate, but what about assets, if you had shares in an enterprise, were they subject to a special restitution regulation?

Peter Jambreč: All kinds of property, the law allows for the returning, the physical return if it is possible. If it is not possible, then compensation. For example, someone owned this hotel in 1945 which was confiscated or nationalised. Then in the next 30 years this hotel was rebuilt, a modern structure came out of it, so actually the initial property was a small part of what is actually here now. So now it is difficult to split the two, the old structure and the new structure, and in such cases it is possible to pay compensation, but it depends on the administrative procedure and the court decision on such a case.

John Moore: A very interesting discussion, I think. One issue that I think we might want to take up is something along these lines, and it is provoked by this discussion we had of the regulation of property and the provision of the Constitution backed up apparently by the European Convention, or based upon that. That the Slovenian state may regulate property in conjunction with social, economic and environmental

purposes, and this is pretty open-ended when you think about it. The issue it brought to my mind at least is this, I think in the US Constitution there is a presumption in favour of the private owner, that generally speaking the rights of the private owner will be paramount. This sounds to me as if the presumption is in favour of the state, that the state will have the right to regulate as it sees fit, the rights of the private individual are secondary in some sense. Now maybe that is a wrong interpretation, but it raises the issue in my mind of how to write a constitution that will protect the free society, the individual against the inevitable etatists, centralisers, authoritarians that are always seeking power and control of the state for that purpose.

Ultimately I think a constitution is just words on paper, but there has to be something under that, that is the real constitution in some sense, the real constitution that is reflected in the words that are on the paper. The question is, what is the source of that and how can that be put into a context that will in fact guarantee the continuation of free society? Anyway, we could talk about that and a lot of other issues that have come up, restitution is certainly one of the big ones I know. I think we can broaden the discussion, now that we have had the introduction and the discussion of the Slovenian Constitution, and go beyond the borders of Slovenia to the region as a whole or beyond that.

Peter Jambrek: I shall complete my comments on this relationship between the social aims which may legitimise government interference with the property rights. In this respect the balance is not completely open-ended, to the interpretation given by the incumbent governments across

Europe and in Slovenia specifically. The European Court of Human Rights developed two tests for regulating this balance, the one is substance of ownership test and the other is to continue testing continuing violations. In the main, the government may restrict or limit the use of property and the exercise of ownership rights, but only to the extent that the rights of an owner remain substantively unchanged, that the individual rights of an owner are neutralised, limited so that nothing remains of them in actual fact. Again, it is a very broad and vague test but still it gives courts across Europe the possibility to draw a line, against government interference with property rights.

The other is continuing violation. As I mentioned before, the denationalisation law in Slovenia does not recognise, in a straightforward way, that someone applying for return of a property was its original owner. He has to prove it. There is an uncertain outcome in the administrative procedure, and the distinction in the Slovenian case that the European Court would consider that even if a grand property was confiscated on a large scale by political measures, several decades ago, it should be considered that a violation of the property rights (for example in 1948 in Slovenia) is a continuing violation and exists for some forty years thereafter. The courts must consider that and adjudicate the case as if it were a recent case such as a couple of years ago. I presume that the European Court would consider an application from a Slovenian former property owner as an existing violation from the past. Compensation should be provided for continuing violation, and in the case of a positive outcome of the court the property should be returned to the original owner.

Finally, I would like to comment on an issue of legal education and of the judges. I think Mr Benacek and I, share the same views on this. Metaphorically, I would agree not only with the abolishing of law schools, but also to abolishing the public radio and television studios. I said this in public quite recently, because it maybe the only efficient way of reforming such institutions. Not that we do not need public television and public radio, but it is so difficult to reform these institutions, shaped and developed over half a century, that it might not be worthwhile attempting to reform. The reform would be perverted and the costs too great, so maybe quite a legitimate model of reform would be to abolish the institution and build from scratch. In the United States this was done in the schools, the university establishments. When a university finds out that a department does not perform according to its standards support is withdrawn and later a new department established. We suspect this more rational solution or model of reform will not happen, but even if it is not we may agree on a more academic point, on ideology of lawyers, of law graduates, and judges in communist countries.

I have had frequent discussions with my Eastern European colleagues in the European Court of Human Rights and we actually agreed that the main aim of re-education and also of the indoctrination of judges was a positivistic view of interpretation. That in fact the lawyers' task is strictly to respect the wording of a statute and apply it routinely, without trying to interpret, and apply the law independently. Some judges were trained like machines applying the existing law rigidly, without any judiciary independence when considering individual cases. As for law schools, I think they train the students in Slovenia to memorise statutes. They do not teach

case law. Surprisingly enough, even constitutional law is taught on a textbook basis. It is usually the interpretation of the professor of the constitution with no relation to the abundant number of cases already in existence in Slovenia in the last fifteen years. They will graduate, but will be unable to draft an opinion of the court, or draft an application to the court. They would be able only to memorise the statutes, and I think that was the basis of an authoritarian state which employed lawyers to adhere to a rigid application of the letter of the law, thus the administration, implemented and bound this hierarchy to the lowest levels of adjudication and law enforcement.

As to abolishing law schools, there is no recipe of course. A realistic scenario would be to establish, next to the existing law schools, a new one, private, independent, which would be able to compete with the state law schools; and not only law schools, but other kinds of university establishments.

Here we come to the same issue of spontaneous and impartial entrepreneurship. It is the same with the education: it is free competition. The free enterprise system should not be restricted to the usual business sector but to other areas, for example education, welfare and so forth. I would be most interested to discuss this application of constitutional provisions of free enterprise to the universities as well.

Bob Reilly: I would like to ask you a question about the philosophical framework of your constitution. In the United States we consider the Declaration of Independence as containing the natural law principles that animate the constitution which then is a prudential application of those

principles. The problem with a positivistic interpretation of the law, of course, is that it has no recourse to natural law principles through which to make an interpretation beyond the rude statement of fact in the law. So do you have that recourse in your constitution, some reference to higher law, natural law?

Peter Jambrek: No. The only thing that I can remember which comes close to the question on philosophy behind the Slovenian Constitution, is that while we drafted it we thought that in the liberal Slovenian society everything should be allowed except that which is firmly and explicitly forbidden. So if there is something that is not regulated by the constitution we would consider that it falls into the domain of free human activity, of the personal freedom of natural and liberal personalities. In this sense this philosophy of everything allowed which is not forbidden, could be complemented by the natural law provisions but somehow that is a little bit distant from my own thinking. I would consider that the ultimate authority in this case is the constitutional law; is the constitutional court and the man-made law. Judges are human beings and experts on the statutes and the constitutional provisions, but still they behave and act according to their own values. In this way the natural law, although the physical person, the judge made law, comes into the Slovenian constitution system as well.

Bob Reilly: But if I may, just one thought... the position you stated and natural law are not complementary; the position you stated is derived from natural law. And if you know where you say this has its source in something higher than itself, then you are simply opening yourself to the same

positivism of law that you criticised, because its nothing other than the product of a group of people, who at one time agreed to something – and does not set a firm foundation of the moral principles upon which they agreed or drew it from. I do not know whether you think that leads to any future dangers or not.

Peter Jambrek: Excellent, we came to a point of disagreement – I do not agree with you. That the constitution making, the constitutional text cannot contain any other kind of morals than those which are written and subject to the interpretation of the judges. And the preamble to the Slovenian Constitution, as with any other kind of preamble, comes closest to what I would identify as the ‘extra’ or ‘super’ constitutional law. But that is in the declaration in the Slovenian preamble of acknowledging national identity, of nationhood, of the permanent right of the Slovenian people to serve their nation. So that I do not know how, in what way, we could derive from the constitution, even from the European Convention on Human Rights any enduring extra legal values. I think that kind of configuration is dangerous. I would avoid it, because that really would be a sign of compromise. Arbitrarily to the constitutional law system which should be rounded by some firm rather well defined frameworks like the text of constitution and well, the judges. That is all I could believe in.

John Moore: Well I think, I probably have in mind the phraseology that ‘all men are created equal’...

Bob Reilly: I am not implying that a constitution should be a philosophical discourse. What I am talking about is a

reference to the moral authority for the constitution, because that is the ultimate thing by which the constitution has to be defended.

Peter Jambrek: Again, that is disputable. It might be that a supernatural being could be considered as a source of constitutional authority. On the other hand, if we only have the constitution as a contract, is also rather prevalent, and it could be considered as a philosophical base of a constitution, as a contract among citizens who agreed in a referendum, in a plebiscite, on the constitution.

Bob Reilly: Right, but that is based upon the moral authority of them to do that, which is derivative of a certain idea of human nature, and laws of nature. I understand as a lawyer that is not something which one would work on a daily basis, or if a judge might. But in a moment of constitutional crisis, you would have to, as did we. We had to go back to our constitutional debates, we had to go back to interpretations of our declaration and we struggled over what were those identifying, ultimate principles on which that constitution was based in order to interpret it or even to argue for the right amendments to it.

Peter Jambrek: The closest we can come together is to the ultimate principles, that they would affect the difference, the workings of the constitution to the degree that a judge, a supreme court judge, or a Slovenian Supreme Court judge believes in them and is informed by them and applies them in working for or against a case in the court.

Bob Reilly: That would seem to me to be a problem unless he had that as an authority that was somewhere explicitly stated, either in a preamble or in some way, otherwise its just his value, and why should it prevail?

Peter Jambrek: Well, that is how Supreme Court judges are acting.

Bob Reilly: That happens in our country too!

Peter Jambrek: The US is an example of a court which can swing and switch its previous decisions in a random way, more than in a European way.

Krassen Stanchev: The Bulgarian constitution was much more competitive than Slovenia's, because there was a special constitutional assembly selected with the clear mandate to draft the constitution. There were many competing drafts and there was an attempt to pose questions, to assign some sort of a framework. Originally the most consensual text was very similar to Locke with regard to property rights. But then a splinter group of the Democrats left the parliament for two months, everything was redrafted, and currently the preamble of the Bulgarian constitution is like Article 2 of the Slovenian Constitution, in the social area. So I make a couple of points, one is the acquisition of private property for public projects as in Bulgaria's experience, and the second is Poland's attempts to entrench economic freedom in the body of their law.

The Bulgarian Constitution basically says that the acquisition of private property for public use should only be carried out as an exception and after due compensation; due, meaning both

process and price. So there was a wealth of applications in the last fifteen years, however, there were attempts to adopt laws to counteract that law. The first attempt was by a Socialist majority in 1995 and they tried to block the restitution of land. Because the Constitutional Court between 1991 and 2002, was basically two-thirds loyalist with no counter balance, they managed to block all these attempts and there were 25 attempts at this, and in all that time the Constitutional Court was acting against to the letter and the spirit of the constitution. But then in 2002 there was a change in the Constitutional Court, and the government drafted two laws, and amended other laws which basically said first take the property and then start the compensation debate. There was much reaction and finally those laws were blocked. But this year we have a Rainbow Coalition with a narrow majority of the seasoned cabinet, and just now they intend to pass this law and they also have the constitutional majority. So we are talking about no compensation in Bulgaria.

Next is Poland. The Poles drafted the first interim constitution with basically the same wording, the same text you have in your constitution, and we have in ours. But then in 1997 they adopted the full constitution which was more reasoned in the protection of private property rights and economic freedom than many other constitutions in the new Europe. But at the end of the 1990s they felt that it was insufficient and they adopted the law on economic activity which was enacted after 1 January 2001, and limited all preliminary to nine activities, including banks and hospitals. Then, because of the EU, because of the UN treaty, they decided that this provision of economic freedom in the Economic Activity Law was not sufficiently effective and

drafted a new law, which was implemented on 1 May 2004: the Economic Freedom Law. This limits even the tax authority's rights to interfere and inspect the files of a company. It is allowed but not more than twice a year, or something like that. This is a very interesting ploy, probably one of the most interesting pieces of regulation written in the last fifteen years.

And last but not least, exit. Most of the new countries adopted new regulations on foreclosure procedures, civic posts. Most of the countries adopted regulations on the rights of restitution and so on. In all these however, the costs of exit has not been tackled in any country sufficiently successfully and this is a major problem.

John Moore: Professor Benacek raises the question of abolishing the law schools. He also raises this question of entrepreneurship again in education, and this was, in a sense, in the context of law and economics. There, I think, is one of the really good examples of entrepreneurship in legal education in America, which was the establishment of the Law and Economic Centre in 1977 by a friend of several of us here, Henry May. Through that centre really, I think, over the course of a quarter of century or so he has transformed legal education in the United States, to the point that now every major law school has an economist, every major law school teaches law and economics. It did not happen overnight, but as I said, over twenty-five years. That was an initiative that Henry took on his own. He raised the money himself, privately, to support the centre and developed it, and through it has had a big impact on legal education and I think it shows

that a good entrepreneur can succeed in higher education as well.

Just a word on this positive versus normative in the legal system. I think Vladimir, you were saying that it is a good idea to have the law of economics to bring a normative element into these divisions in the system and I think Peter, you were saying that positive law was best. In the US of course it is basically a common law system, as in the United Kingdom, and in that respect very different from the law here, the system here. The introduction of economics into the law was intended in the first place to enable judges to understand the economic aspects of the cases that were before them, many, many cases have economic aspects, not necessarily to direct them, although it does have that sense as well. The other purpose for it, is understanding that lawyers write laws and it would be good if the people writing the laws would have an understanding of the economic implications of the laws they are writing. There again law and economics provides a normative vehicle almost as important but that is on the legislative site not on the constitutional side.

Silvana Malle: A question on the composition of the constitutional court and how it decides it to operate, I understand how it has a communist history. You also say that most of the commentaries in the law were already laid down, but after these changes in the composition of the constitutional court did you notice any sign of twisting the interpretation of the law in a sense that affects human rights?

Peter Jambrek: I think it is consistent in the way it is interpreted, in the way it is applied.

Andrzej Brzeski: I want to go back to Bob Reilly's question. Most legal systems of whatever kind are against stealing. You can think that is because of the disfunctionality of a society where stealing is common and not prohibited, but you can also think about it in a different way, which goes way back, namely that disfunctionality of stealing which before is forbidden by being law, is because it violates one of the commandments. So this way you go back to the religious foundations of law, certainly of good law.

Bernard Brscic: I think we have raised some really important questions regarding the relationship with the inconsequentialist approach that Professor Jambrek seems to be advocating and the theological concept that both Bob Reilly and Andrzej Brzeski are advocating. You described the constitutional judges as a kind of dictators who basically impose their value system on the society, and what I have a problem with is basically the relationship with the legality that you endorse and legitimacy. I think that there are certain absolute values that even the constitutional judges must abide by, even though it might be against their own value system. I am not saying it must be God, but certainly they do derive from human nature. If one looks at Nazi Germany for example, the legal system in the Nazi Germany, it was a kind of positive law that basically legalised annihilation of, and the genocide of the whole parts of the population, and you cannot really go beyond the ethical dimension of a human being. Perhaps I misunderstood you, but do you claim that the constitutional judges are guardians of the truth? Or have I interpreted you incorrectly?

Bob Reilly: I would just like to amend Andrzej's suggestion, because it is particularly difficult if you call upon a specific revelation as your authority for legislation, because why should people who do not share that revelation accept it as an authority. This afternoon I will be talking about Islam, and of course, in many of the Islamic countries if you are not a Muslim you are out of luck, you are an infidel. Therefore, the conception of justice which has to inform a constitution, by definition, should be expressed at the level of a natural law. It does not appear to me that there could be any other way since it has to justify a political arrangement which recognises the moral necessity of free choice reached reasonably. If you can not defend that, as Bernard says, you are leaving yourself open to anything that either a legislature should decide or a judiciary should decide.

John Moore: One way to put that question, I think, is to ask whether justice is more than merely the interpretation of the constitution or if justice amounts only to being sure that actions are consistent with the written constitution.

Ljubo Sirc: At the end of the Middle Ages law was defined as minimum morality, which means that it remains as vague as is morality. It is very difficult, and of course written law helps, but written law is then also limited. You do not apply the whole of morality, you leave out certain things so you are not concerned about them. If, for small things the court is not really concerned about dealing with, what small things are is of course a gradual definition. And it goes on and on and you never reach an end. It depends on whether people are sensible or not; and one hopes that the majority is sensible and that the majority determines the laws. That they will not be based

entirely on selfishness, but also, as Hayek said, keeping in mind that you may be on the other side next time round. But it all really depends on good sense, and there is no final definition of anything, I am sorry to say, and minimum morality is as good a definition as any for the law.

Bob Reilly: I would agree with Ljubo that it is absolutely the case. The minimum morality is stating the case somewhat negatively, though Thomas Aquinas recognised it in that manner as a prudential thing. The standard for law is public order, to maintain public order. And why? Why do we need public order? In order to allow the pursuit of private good. Now that does not mean that private good is arbitrary. In a way public order points you to the achievement of what private good may be, and well being. In other words, what is good for a human being is not arbitrary but according to his nature. But if you are, within the context of public order, allowed to pursue that freely, and which, as a moral creature is what you ought to do. The application of what is achievable in terms of public order is always a matter of prudence, and has to be applied according to the circumstances of your society and your culture. Aquinas could see that. It may not be wise to forbid prostitution, because it could be a worse problem than if it were publicly regulated and controlled in some way. So, the application of it is always prudential, but the larger moral concept, is there pretty solidly in terms of what the public good means and as it is related to the public order and the private good.

Peter Jambrek: I have some difficulty in understanding Mr Reilly's points. The closest I can come is that there is a difference in terms of respecting the law. Well each one of us

as an individual citizen is respectful, very respectful of the law, out of his/her individual convictions, values, natural law considerations and so forth, so I would totally agree that sources of legal behaviour are various and different for each one of us. The other is the enforcement of the law, application of the law, by the machinery of the state, and here I will refer more or less to the courts. They are quite practical instruments, and the judges are, in a way, law enforcement officials, they apply the law, and here they can rely on two things. We can face the situation as in the United Kingdom where there is no written constitution. In this situation the judges have a wide margin of appreciation, taking into account witness statements. So for practical purposes, a judge in a normal constitutional state, is bound by something that requires written statements. In this respect, I may mention two or three interesting points in the Slovenian constitutional discourse, one is that when the Slovenian constitution was drafted, by the group of which I was a part.

In the preamble we stated that the Constitution is based upon the notion and the value that life is sacred. This seemed to be a compromise between the religious population of Slovenia and those who may not be Catholics or members of other Churches. Sanctity and sacredness of life however, in the elementary debate, was strongly opposed by the atheists and by the clergy. It satisfied no one. So it was dropped from the constitutional text, although it seemed that it would give this kind of a natural law a source of inspiration to the whole constitutional case. I was very sorry for this revision.

The other textual symbol that comes closer to the natural law notion is something that again was explicitly and in a well

defined way omitted from the Slovenian constitution, that is the concept of *dignitas*, of human dignity. The German constitution had it, in which the value of human dignity implies the right of everyone to develop his human personality, and from this you derive the right of freedom of human action. This is more closely related to the topic we are talking about, free enterprise. In the many jurisprudences in Germany, the freedom of competition is also legitimised, constitutionally, by the use of these phrases of human personality, human dignity and freedom of human action. Again, that is one point of the Slovenian constitution we, as drafters of the constitution, did not succeed in persuading the constitution writers to include in the text in a sufficiently well defined way.

Two further points which might be worthwhile mentioning. First, is the Constitutional Court's notion of the values of civilised nations. When we were dealing with the post-communist legislation on property confiscation and the arbitrary manner of the application of the criminal act, for mass executions and arrests, we had to consider that these were valid laws in 1947/48. In extraordinary proceedings before the Supreme Court, even today, those laws have to be taken into consideration. So the Slovenian Court would have to say that those laws were invalid even at the time they were passed, , because they were against the norms and values of civilised nations. So here is broadly what became real term according to case law in Slovenia.

My second point, and the last I wish to mention, is the law on equality. Here, the prosecution courts are developing the text for equal treatment for equal situations, and the obligation of

the government to treat different situations, appropriately. It is a very simple idea which stems from the ancient Greek. Aristotle calls on equality and in this sense the natural law or the very, very old humane notion also became a part of the constitution we now know.

John Moore: To me that was very, very helpful, because it tells me that there were some principles you had in mind when you sat down to write the constitution. It was not simply arbitrary; there was something there. You questioned the sanctity of life, the idea of human dignity. This idea of equality before the law, those were things that were guiding the constitution, and I think in a way that was what Bob was saying.

Bob Reilly: Yes indeed. I am curious, did the norms of what civilisation was developed, was that in case law or in the constitution?

Peter Jambrek: That was case law.

John Moore: I must say we tried to get back to entrepreneurship here and in a sense we have strayed far from that subject, but not really because I think much of this is very basic to the ideas that motivate or animate a free society and therefore a society in which entrepreneurship is an important factor.

Rasto Ovin: Perhaps I could add something. As dean of a faculty of economics and business, I find this very interesting, and I try to do my best in leading the business school towards maximum goals of a bright society; to enable people access to

knowledge and, of course, to get a university institution to address problems of real life, which means offering relevant knowledge. I look forward to processes where in Slovenia we will enable people better access to relevant knowledge. I am also a member of a special commission on a consultation on private education in Slovenia, so we deal with many proposals. I believe what we should do here, is to assure all participants, an equal starting point. I also did not understand your idea of destroying state schools and then seeing what happens, because then we have confusion. This causes disfunction and we owe it to our students to ensure that programmes are as the students expected when they were enrolled. But I strongly agree, that, in a way, we assure at least a public-private partnership. I agree that the criteria must be set for universities, especially in some new disciplines. You can hardly intervene in theology and philosophy for example, but more should be done on practice of the economy, and certainly in business schools. We should ensure competition, we should ensure civility for the private sector, as in the United States where there may be state universities but they must acquire funding from the private sector. So in the field of high education, particularly in business schools, they should act as entrepreneurs otherwise we cannot say we are teaching entrepreneurship if we ourselves do not have to be entrepreneurs.

Silvana Malle: You have law courses at this business school?

Rasto Ovin: We do, but mostly in the faculty.

Alja Brglez: Professor Benacek opened the discussion at exactly the point where I wanted to enter, but then the other

discussion on constitutional courts having the rights of ancient prophets was so inviting that I did not want to interrupt. However, I should like to share a practical case of establishing a private faculty for economics in Slovenia. This is exactly how entrepreneurial spirit can enter a field where before it was a rarity before. I would like to ask Professor Jambrek if in his opinion, Slovenia is lagging behind in establishing this kind of institution in the last fifteen years, and behind other countries in the region. I think Slovenia is lagging behind. To my knowledge no more than three institutions were established and fully functioning in the last fifteen years. One is in the field of humanities, the other is Polyteknika, and the other is your college. My question is, what were the reasons for not being more active in that respect so far, and do you see the means and mechanisms to do that in the future, now you are chairman of the Council for University Affairs?

Peter Jambrek: The Council is an advisory board to the government and also a body which accredits, gives public credibility to study programmes and to new schools, graduate schools and so forth. In Slovenia there are a couple of independent, not necessarily private, which means non-government, but not funded by private individuals but by local self-governing or other public institutions. So I think there are only two private university institutions in Slovenia right now, including all those which are independent, non-state. They have fewer than five percent of the country's students. So an approximate estimate, but please correct me if you have a better figure for the United States, is that one third is private. The European Union Commission responsible for education say that the European Union is striving for the same proportion of one third in private institutions. However, I

would say that even Slovenia's five percent is high in comparison with some continental European countries. In Germany there are one or two private university schools, and maybe one in Austria, in France; Switzerland has not even one private faculty. The situation across Europe is rather disappointing hence the 'Bologna process', led by the education commissioner, which tries to implement large scale reforms of the European universities because Europe is lagging behind United States in this respect.

Foreign students flock to the excellent private American universities, not to the European ones; the same as far as Nobel Prize winners and researchers and so forth are concerned. Europe is not only lagging behind, but is losing its intellectual power, which translates into technological power; and as a continent it lags behind. Even now there is no indication of competition being offered between Europe and United States; the only competition is between Chinese universities and United States. Europe is nowhere, hence the minister's motivation to increase the private sector. I would consider the Slovenian situation rather more promising than the German or Swiss in this respect.

With regard to the law on establishing a university of faculties, this is very simple and legally nationals and foreigners may establish a university institution in Slovenia according to legal criteria. The first law on universities in Slovenia was enacted in 1992 after the democratic upheaval. But of course application of the law depends on the governing elite. So as in all other spheres of the free market economy, there may be obstacles in the way of establishing a new school, or the government may actually try to encourage the

establishment of a school centre as a large private sector in education.

I know from my personal experience that the incumbent government is having to work for the establishment of as many new schools as possible in the private sector and indeed it is an explicit government programme. My own mission as chairman of this board, I understand, is to encourage the twenty board members, but I would say most members represent public universities, and they defend the status of their own institutions. So the Council for University Affairs is similar to a big lobbying institution where there are intervening interests and conflicts of interests, and the private sector is represented on this board by a minority. Whatever the chairman does, he is only one, one vote per head, and there is no way I could even think about manipulating anything that goes on, so what we can do is try to liberalise the ways our laws function.

John Moore: Thank you very much Professor Jambrek for not only introducing the discussion, but also for your active participation in it. I think we all appreciate your coming today to meet with us at this conference. Thank you all for your participation.

Fourth Session

The Continuation of the Communist "Disturbance" and the new "Islamist" Threat

The Roots of Islamist Ideology by Robert R Reilly

First, I should like to say, that I do not pretend to originality concerning the ideas presented in this essay, though I am responsible for the way in which they have been synthesized. I particularly recommend, and have drawn upon, the works of Malise Ruthven (*Islam in the World; A Fury for God*); Fr. Stanley Jaki (*Jesus, Islam, Science*); Barry Cooper (*New Political Religions*) and Fr. James Schall (in a number of articles available on his web site). The views I express do not necessarily reflect those of *Crisis Magazine*

“Dost thou not know that God has the power to will anything?” — Qur’an 2:106

“Wherever I go in the Islamic world, it’s the same problem: cause and effect; cause and effect.” — Fouad Ajami, 2005

The ideas animating terrorist acts from 9/11 to the 7/7 London bombings and beyond have been loudly proclaimed by their perpetrators and their many sympathizers in every form of media. We know what they think; they tell us every day. However, questions arise concerning the provenance of their ideas, which they claim are Islamic. Are they something new

or a resurgence of something from the past? How much of this is Islam and how much is Islamism?¹¹ Is Islamism a deformation of Islam? If so, in what way and from where has it come? And why is Islam susceptible to this kind of deformation?

Quite some time ago, an answer to the first question was proffered by the famous British author, Hilaire Belloc. In *The Great Heresies*, published in 1938, he predicted the resurgence of Islam in the following way:

Since religion is at the root of all political movements and changes and since we have here a very great religion physically paralysed but morally intensely alive, we are in the presence of an unstable equilibrium which cannot remain permanently unstable. A few pages later Belloc wrote: “That [Islamic] culture happens to have fallen back in material applications; there is no reason whatever why it should not learn its new lesson and become our equal in all those temporal things which now *alone* gives us our superiority over it — whereas in *Faith* we have fallen inferior to it.”

Belloc saw the coming resurgence of Islam within the context of Islamic history from the 7th to the 17th centuries, at the end of which the Turks were stopped for the second and final time

¹¹ Islamism is used here as a form of shorthand for Muslim totalitarian ideology. It is in some ways an unsatisfactory term as there are self-proclaimed Islamists who would not subscribe to this meaning of the term.

outside the gates of Vienna. A revived Islam, he seemed to say, would be more of the same, yet now equipped with modern technology. It would be an even more lethal foe against a West weakened by its loss of faith.

As prescient as Belloc may seem, can one adequately understand what is happening today in the terms he suggested? The centuries-long expansion of Islam came from the center of an extraordinary dynamic that thrust out to the boundaries of its potential, but then slowly subsided into quiescence. The Islamic world was jolted out of its several centuries of torpor only by intrusions from the West. By the early 19th century, the West had demonstrated such a decisive superiority over Islamic culture that Islam's defensive attempts to recover from its influences have been indelibly marked by the very things against which Muslims were reacting. To resist the West, they became, in a way, Western. As Raphael Patai pointed out in *The Arab Mind*, the very standards by which Muslims measure their own progress are Western. In a final irony, the most rabid ideological reactions against this state of affairs in the Muslim world are also infused with Western ideology. Islamists practice a perverse kind of homeopathy which uses the very disease from which they are suffering to combat it, but with dosages that are lethal. Belloc did not foresee this.

Islamist authors cannot be accurately understood in the terms of Islam simply, but only within the perspective of the 20th-century Western ideologies that they have assimilated, most especially those of Nietzsche and Marx. The seminal thinkers in Islamism, like Sayyid Qutb in Egypt, were very well versed in Western philosophy and literature. Qutb went to the United

States for several years of post-graduate studies. He was completely repelled by what he saw as a materialist culture. For example, he thought that the way Americans cared for their lawns was a sign of materialism and that the parish dances he witnessed were examples of sexual degeneracy. His exposure to the West intensified his hatred of it. The solution to what he diagnosed as Western alienation was Islam. Islam could overcome the relativism and the moral degeneracy that he had observed during the late 1950s. Islam would save the West as well as the East. In order to do this, Qutb said that Muslims must emulate the behaviour of the companions of the Prophet to prepare for the struggle ahead. He used Leninist terms and means, espousing a “vanguard” of the faithful which would lead the restoration of the Caliphate. (In fact, Qutb was the Muslim Brotherhood’s liaison to the communist party in Egypt and to the Communist International.) Because of his opposition to the Egyptian government, Qutb was hanged by Nasser in 1966. He is said to have gone to the gallows smiling, leaving that iconic image to inspire his followers today.

The highly heterogeneous world of Islam stretches from the Atlantic to the Pacific, from Morocco to the southern Philippines. There are very few things that one can say about the Muslim world that are true in all these places. Of the 44 predominantly Muslim countries in the world, 24 do not use Islamic law as their primary source of laws. While Muslims everywhere observe the five pillars of Islam, they are culturally very different in, say, Indonesia and the Arab world. However, this highly heterogeneous character is in danger of being homogenised. The engine for the homogenisation is Qutb’s Islamist ideology, which has

demonstrated tremendous cross-cultural appeal. Qutb's writings are considered the new writ, along with those of Sayyid Maududi and Hasan al-Banna, the founder of the Muslim Brotherhood. Qutb's teachings are at the foundation of, for instance, the Justice Party, which is the fastest-growing and only dues-paying party in Indonesia. It was the first on the scene with aid after the tsunami. The Hizb ut-Tahrir organisation, which is banned in most Muslim countries, has had quite an impact in Central Asia and Western Europe. The foundation of its ideology is also Sayyid Qutb. The people at whom Hizb ut-Tahrir aims are the intelligentsia and the upper middle-class across the Islamic world. Hizb ut-Tahrir does not explicitly advocate violence and terrorism, but prepares the intellectual foundations for it by using Qutb's teachings. On the other hand, Al Qaeda, also spawned by Qutb's ideology, explicitly promotes violence in the 60 some nations in which it has a presence. So does the Islamic Jihad in Palestine, which is inspired by Qutb's teachings. In other words, this is not a local phenomenon. The cross-cultural appeal of this ideology reflects a deeper crisis within Islam itself. It is in its most exacerbated form in the Arab world, but it exists everywhere in the Muslim universe or Umma.

Why is Qutb so popular and influential? There is a two-fold answer. Part of the explanation comes from the abiding sense of grievance within Islam to which Qutb's ideology plays. Another part comes from the outcome of an ancient struggle within Islam over the primacy of power as against the primacy of reason. First, it is essential to understand the magnitude of this sense of grievance, which comes from and is exacerbated by Islam's exposure to the West. Because of it,

Muslims have to find some way to explain the last several centuries of senescence.

I have been going through *Mein Kampf* to see what parallels there may be to this sense of grievance. The choice is not adventitious. There were associations between the Nazis and the early Islamists going back to the 1930s, when Hassan Al Banna modelled the Muslim Brotherhood on the Brownshirts. The German sense of grievance came from defeat in World War I and the metaphysical shock of the collapse of the Second Reich. This loss was inconceivable to them. The world had somehow been turned upside down. To comprehend the loss, Hitler and his companions explained it in terms of, first, the internal enemy and then the external enemy. Germany was stabbed in the back. Where was the rot in German society from which this betrayal came? The racist Nazi answer was the Jew. Germany must expunge the Jew and purify itself for the battle against the external enemy in order to bring about our millenarian vision of the Third Reich.

A similar narrative of grievance and recovery exists among the Islamists who are still in a state of shock over the abolition of the Caliphate by Kemal Atatürk in 1924. With the collapse of the Ottoman Empire at the end of World War I, the Caliphate was but a shell of itself. Nevertheless, its abandonment left some people completely adrift. It was as if the Vatican had abjured its authority to represent the Church. How could the abandonment of the Caliphate be explained? Islamists began looking for the internal enemy and then the external enemy.

Islamists try to focus the widely-shared sense of grievance and humiliation in the Muslim world on the loss of the Caliphate because they wish to restore it. While most Muslims may not share in the Islamist mythology regarding the Caliphate, which did not exist continuously from the time of Mohammed, they nonetheless do require an explanation for the decline of their civilization. The need is particularly acute because Islam mandates the success of the kingdom here for its validation. Mohammed did not arrive and say that Allah has told him that God's kingdom is only in the next world. Allah said, establish my kingdom here and everywhere. The Dar al-Harb, the "land of war," meaning the non-Muslim world, must be made part of the Dar al-Islam, the "land of peace." The astonishing success of Islam in its first centuries confirmed the prophecy for its believers.

This began to change in 1798, when Napoleon defeated the Egyptian armies at the Battle of the Pyramids (or perhaps before, when the Ottoman Empire was forced to sign the Treaty of Kucuk Kaynarca in 1774 with Russia). As Abd al-Rahman al-Jabarti observed at the time, the proper order of things as divinely ordained had been overturned. The Muslim world began to experience enormous theological, philosophical, and political confusion. How could this defeat possibly have happened in the lands of Islam? Failure is particularly galling when there is a theological imperative to succeed. Things got much worse after World War I, with the collapse of the Caliphate, the secularisation of Turkey, and the almost complete colonisation of the Levant and the Maghreb. There was the old enemy, the West, ruling over Muslims. In Muslim teaching, a non-Muslim is not allowed political office in a Muslim country. It is a scandal for an infidel to rule over

a believer. Suddenly, a huge part of the Islamic world was being ruled by the West. How could this be understood within the tenets of the faith?

The answer must be that this was a rebuke from Allah because Muslims have not followed his ways. Just as success is a validation of faith, failure is a personal rebuke. Within their theological viewpoint, defeat by a superior power must be interpreted as a judgment from Allah that Muslims have deviated from his path. The model for success is, of course, the Companions to the Prophet. So, said Qutb, Muslims have to remove the accretions of the ages and within the history of Islam, and go back to that original community, model themselves on the Companions and prepare to do what they did — to retake the world, and to re-establish the Caliphate. The instrument for doing this, depending on which Islamist you talk to, is a combination of persuasion and jihad, or simply jihad. Qutb blamed the Jews in Istanbul for conspiring in the collapse of the Caliphate (“The Jews have always been the prime movers in the war declared on all fronts against the advocates of Islamic revival throughout the world.”), and labelled impious Muslims as the internal enemy, who must be vanquished so that the infidel West could be confronted and overcome.

The infection of Western millenarian ideological thought would not have made Islamism the attraction it is unless Islamism was not also able to claim legitimacy by drawing upon something within the traditions of Islam itself. For this, Islamist thinkers very selectively chose one, albeit a primary one, of the many theological and philosophical traditions within Islam’s rich history. The Islamist use of this tradition

needs to be understood within the broader perspective of a struggle that has taken place since Islam's inception over the status of reason and revelation. The outcome of this struggle decisively affected the character of the Islamic world in which Qutb could find such a ready audience for his ideology. The argument, already begun in the seventh and eighth centuries, was over the status of reason in relationship to God's omnipotence. This struggle had its roots in a profound disagreement over who God is. Ideas have consequences, and no idea is of greater consequence than the definition of God.

The Mu'tazilite school, composed of the Muslim rationalist philosophers, fought for the primacy of reason. They held that God is not only power, he is also reason. Man's reason is a gift from God, who expects man to use it to come to know him. Through reason, man is able to understand God's reason as manifested in his creation. God's laws are the laws of nature, which are also manifested in the Sharia. Since reason is an attribute of God, his revealed words in the Qur'an are decipherable by man's reason. This means that the Qur'an is open to interpretation.

The Qur'an is open to interpretation because it was revealed in history at certain time to a certain people under certain circumstances. To understand what is meant in the Qur'an, the Mu'tazilites said, we have to interpret it because, today, we are living in different circumstances, at a different time in history. Therefore, we must have an historical understanding of what was meant at that time in order to apply Qur'anic principles to our time.

The Mu'tazilites succeeded to the extent of having the teaching of a created Qur'an enshrined as a state doctrine, proclaimed in 827 under Caliph Al-Ma'mun. The Mu'tazilites had to fight for the primacy of reason and actually required religious judges to swear an oath that the Qur'an had been created. Those who believed in the primacy of power and the uncreated Qur'an could be and were punished and imprisoned. However, after the reign of Harun al-Watiq, the tables were turned on the Mu'tazilites by Caliph Ja'afar al-Mutawakkil (847-861), who made holding the Mu'tazilite doctrine a crime punishable by death. The Mu'tazilites were forcibly suppressed. This did not end the Mu'tazilite school of thought (some fled to the more hospitable Shia areas) nor prevent the flourishing of the Greek-influenced *faylasuf* (philosophers) who followed them, such as Alfarabi, Avicenna and Averroes. However, the long process of ossification had begun. By the 14th century, it had reached a stage that led Arnold Toynbee to say of the greatest Islamic thinker at that time that "the loneliness of Ibn Khaldun's star is as striking as its brilliance."

An apt symbol of the tension between reason and revelation in Islam was the famous library of Cordoba. It was one of the glories of the Moorish civilization. In the 10th century, the library contained some 400,000 volumes — more books than were in France and quite possibly all of Western Europe at that time — with some five hundred attendants. However, Muslims not only built it, they also burned it down. In 1192, the first batch of books, apparently by Mu'tazilite authors, was set to the torch because they advocated the primacy of reason. There is a much earlier apocryphal story of Caliph Omar ordering the destruction of the library of Alexandria in

638. The story is most likely spurious (as the library did not exist at that time), but he is supposed to have said, “These books either contain what is in the Koran or something else. In either case, they are superfluous.” More recently, the Taliban, following a similar injunction, ordered the destruction of all books in Afghanistan except the Qur’an.

Though one cannot so neatly characterize the events as Mu’tazilite and Ashari respectively, this same tension was manifested in a sartorial way in modern Turkey’s state violence against those who would not adopt modern dress under Atatürk’s secularization program, and the shooting of Palestinian Arabs who resisted wearing traditional Islamic dress under the reign of Mohammed Amin al-Husseini, the grand mufti of Jerusalem and Hitler’s close ally.

Doctrinally, the anti-Mu’tazilite school held that the Qur’an was not created in time; the Qur’an has co-existed with Allah from eternity in Arabic, as it exists today. Therefore, there is no need to interpret it; it is not open to interpretation, or *ijtihad*. It is proclaimed in the same way at every time to all peoples, who simply need to apply it. This shuts the door to *ijtihad*. That is how decisively the Mu’tazilites lost. *Ijtihad* is over (at least, for the Sunnis); there’s no more interpretation. It has all been said. All must now obey, or submit.

This victorious view developed a theological basis for the primacy of power by claiming that the revelation of Mohammed emphasizes most particularly, and above all, one attribute of God, and that is his omnipotence. All monotheistic religions hold that, in order to be one, God must be omnipotent. However, this argument reduced God to his

omnipotence by concentrating exclusively on his unlimited power, as against his reason. God's "reasons" are unknowable by man. God rules as he pleases. He is pure will. There is no rational order invested in the universe upon which one can rely, only the second-to-second manifestation of God's will.

God is so powerful that every instant is the equivalent of a miracle. Nothing intervenes or has independent or even semi-autonomous existence. In philosophical language, this view holds that God is the primary cause of everything and there are no secondary causes. Therefore, what may seem to be "natural laws," such as the laws of physics, gravity, etc., are really nothing more than God's customs, which he is at complete liberty to break or change at any moment.

The consequences of this view are momentous. If creation exists simply as a succession of miraculous moments, it cannot be apprehended by reason. Other religions, including Christianity, recognize miracles. But they recognize them precisely as temporary and extraordinary suspensions of the natural law. In fact, that is what defines them as miracles. One admits to the possibility of a miracle only after discounting every possible explanation of its occurrence by natural causes. In this type of Islamic thought, there are no natural causes to discount. As a result, reality becomes incomprehensible. If unlimited will is the exclusive constituent of reality, there is really nothing left to reason about. One has simply to accept it. Likewise, the word of God in the Qur'an is not to be understood, but obeyed.

The early-10th century thinker Abu al-Hasan al-Ashari elaborated a metaphysics for the anti-rational view by using

early Greek atomistic philosophy to assert that reality is composed of atoms. The configuration of these atoms at any given moment makes things what they are. In *Islam In the World*, British analyst Malise Ruthven explains that: “The Asharis rationalised God’s omnipotence within an atomistic theory of creation, according to which the world was made up of the discrete points in space and time whose only connection was the will of God, which created them anew at every moment.” For example, there is a collection of atoms which is a plant. Does the plant remain a plant as you are reading this line because it has the nature of a plant, or because Allah wishes it to be a plant from this moment to the next? The Asharites said, yes, it is only a plant for the moment. For the plant to remain a plant depends on the will of Allah, and if you say it has to remain a plant because it has the nature of plant, this is *shirk* — blasphemy.

The catastrophic result of this view is the denial of the relationship between cause and effect. In *The Incoherence of the Philosophers*, Abu Hamid al-Ghazali (1058-1111), who vehemently rejected Plato and Aristotle, insisted that God is not bound by any order and that there is, therefore, no “natural” sequence of cause and effect, as in fire burning cotton. There are only juxtapositions of discrete events that make it appear that the fire is burning the cotton, but God could just as well do otherwise. In other words, there is no continuous narrative of cause and effect tying these moments together in a comprehensible way.

In attacking the Mu’tazilites, the Asharites, in the words of Muhammed Khair, wished “to free God’s saving power from the shackles of causality.” The price for this liberation was the

loss of the principle of contradiction — i.e. something cannot be, and not be, in the same way, at the same time, in the same place. Without the principle of contradiction, reality becomes unrecognisable. This view results in anti-rationalism which, in turn, produces irrational behaviour. Modern manifestations of the resulting confusion are many. Fr. Stanley Jaki has pointed out that, several years ago, an Imam in Pakistan instructed physicists there that they could not consider the principle of cause and effect in their work. Dr. Pervez Hoodbhoy, a Pakistani Physicist and professor at Quaid-e-Azam University in Islamabad, said, according to *The New York Times* (10/30/2001), that “it was not Islamic to say that combining hydrogen and oxygen makes water. ‘You were supposed to say that when you bring hydrogen and oxygen together then by the will of Allah water was created.’” There are people in Saudi Arabia today who still do not believe man has been on the moon. This is not because they are ignorant; it is because accepting the fact that man was on the moon would mean also accepting the chain of causal relationships that put him there. That is simply theologically unacceptable to them.

In the place of reasonable explanations — or of explanations subject to reason — conspiracy theories reign. The Islamic press is rife with them. Conspiracy theories are the intellectual currency in an irrational world. When Hurricane Katrina hit the southern United States, a typical report in the Arab press announced that “Katrina is a wind of torment and evil from Allah sent to this American empire” (Muhammad Yousef Al-Mlaifi, *Al-Siyassa*, 8/31/2005) or that “the only reason for this disaster is that Allah is angry at them” (Dr. Khaled Al-Khaledi, *Al-Haqaeq*). Most Americans see this as just crude propaganda without realizing it stems from a theological

perspective that requires an understanding of the event as the result of a first cause. It is the necessary view of people who have to interpret it in exactly that way because their philosophy does not allow for the existence of secondary causes.

What is true for nature is also true for man within this anti-rational perspective. Other than as manifestations of Allah's will in man's actions of the moment, how is man's story to be told? The Qur'an is no help here because it is not in a narrative form. History requires a rational sequence of causal relationships. The Asharite view so permeated Middle Eastern consciousness that it ultimately affected the Arab sense of time (no clocks on mosques), leading to an indifference to dates and a certain impetuosity of character, and subverted the Arabs' interest in their own history, which was minimal until Western historians provoked it by writing that history first.

To outsiders, this capricious dimension of Islam was clear as long ago as the Middle Ages when the great Jewish philosopher Maimonides (1135–1204) spoke of his experiences in Cairo to illustrate the way some Muslims think. Every morning the Caliph rides through Cairo and every morning he takes the same route. However, said Maimonides, tomorrow he could take a different route. Why? Because he is the Caliph and he can do as he wills. Every morning the sun rises in the east and sets in the west. It has happened for years; it happened today. But tomorrow it might rise in the south and set in the north. That depends on the will of Allah and there is no saying that it will not. Maimonides concluded that “the thing which exists with certain constant and permanent forms, dimensions, and properties (in nature)

only follows the direction of habit ... on this foundation their whole fabric is constructed.”

Maimonides was not the only one to have noticed that this is a problem. In *Lectures on the History of Philosophy*, Hegel observed that, in this version of Islam, “the activity of God is represented as perfectly devoid of reason.” In *The Decline of the West*, Oswald Spengler wrote that “Islam is precisely the *impossibility of an I as a free power vis-à-vis the divine*. . . . In the entire cosmic cave there is only one cause which is the immediate ground of all visible effects: the deity, which itself has no longer any reasons for its acts.”

This conception of God directed man’s relationship to the Almighty in a specific way. A God who has no reasons cannot be known. This view can and did, in this form of Islam, lead to a rich vein of mysticism, but it also presents a problem. How should one behave toward an unreasoning God? Ibyn Taymiyya (1263–1328), a medieval Muslim thinker, who profoundly influenced the founder of Wahhabism and who has been resuscitated by the Islamists today, answered: man’s task is not to know God; God is unknowable; do not even try to know God. Man’s job is not to love God. Man cannot love what he does not know. Man’s job is to obey. Submit. Reason plays no role and free will is denigrated. In his attack on philosophy, entitled *Kuzari*, Judah ha-Levi, a Jewish follower of al-Ghazali, reached the logical conclusion of how man ought to approach the revelations of such a deity, “I consider him to have attained the highest degree of perfection who is convinced of religious truths without having scrutinized them and reasoned over them.” (How, one wonders, does one

become “convinced” of something without having thought about it?)

Compare this relationship to the standard definition of a Christian vocation, which is expressed in this logical order: to know, to love, and to serve God. First, knowledge of God is required. How can one love what one does not know? Of course, it is assumed that a finite creature such as man can only comprehend a small part of an infinite God, but can know enough to inspire love. God is knowable. If one knows God, then one loves him. In turn, the obligation of that love is to serve. One is naturally drawn to serve what one loves. The expression of this vocation is internally coherent and logically ordered. It is based upon a certain view of who God is and how man is capable of freely responding to him through the use of his reason and free will.

To understand the ultimate significance of the Asharite teaching of an unreasoning God, it may also be helpful to contrast it to the Christian teaching that was similarly tempted to such extremes, but resisted them. Why, for instance, did this exclusive preoccupation with God’s omnipotence not afflict Christianity, which is, after all, also monotheistic? Christianity holds that God is omnipotent and the primary cause of all things, as well. In fact, there were strong tendencies within Christianity to move in the very same direction as the Asharites. The early Christian thinker Tertullian questioned what possible relevance reason could have to Christian revelation in his famous remark: “What has Athens to do with Jerusalem?” The anti-rational view was violently manifested in the millenarian movements of the Middle Ages, and somewhat within the movement that was

known as fideism — faith alone, *sola scriptura*. In its most radical form, this school held that the scriptures are enough. Forget reason; forget Greek philosophy; forget Thomas Aquinas. However, the anti-rationalist view in its more extreme forms has never predominated in Christianity, and was considered broadly heretical.

The reason Christianity was insulated from an obsession with God's omnipotence was the revelation of Christ as Logos in the *Gospel of St. John*. If Christ is Logos, if God introduces himself as *ratio*, then God is not only all-powerful, he is reason. While the Mu'tazilites claimed something similar, they had no scriptural authority to confirm their position, while their opponents had many to oppose it.

Also, Christian revelation claims that everything was created through Christ as Logos. Since it was through Logos that all things were created, creation carries the imprint of its creator as reason. Nature bespeaks an intelligibility that derives from a transcendent source. Benedict XVI recently reiterated this view when he referred to the "world as a product of creative reason." This view constitutes an open invitation to examine the rules and laws of creation in order to know the Creator, an invitation very familiar from the old Testament. In *Romans I*, St. Paul reiterated it by saying, "ever since the creation of the world, the invisible existence of God and his everlasting power have been clearly seen by the mind's understanding of created things." The laws of nature are not a challenge to God's authority but an expression of it. Reason and Christian revelation are compatible. The tension between Athens and Jerusalem was reconciled in Rome.

Ultimately, this theological view developed into the realist metaphysics of Thomas Aquinas, which then became the foundation for modern science, as Fr. Stanley Jaki, a Hungarian theologian and physicist, has explained in his voluminous writings on the origins of modern science. He has, as well, laid out the reasons modern science was stillborn in the Muslim world after what seemed to be its real start (see his extraordinary monograph, *Jesus, Islam, Science* — Real View Books). No one offers a more profound understanding of the consequences of the view of God as pure will than Jaki has. The metaphysical support for natural law not only laid the foundations for modern science, but also provided the basis for the gradual development of constitutional government.

The primacy of power in Islamic thought undermined a similar prospect. If one does not allow for the existence of secondary causes, one cannot develop natural law. If one cannot develop natural law, one cannot conceive of a constitutional political order in which man, through his reason, creates laws to govern himself and behave freely.

If man lives in a world of which he can make no sense, a world that is a plaything of the gods or of God, an irrational world, he can choose only to surrender to fate or to despair. Reason and freedom become irrelevant. If man is not a political creature endowed with reason in a world accessible to his mind, why attempt to order political life based upon deliberation and representation? In such circumstances, man will not go about writing constitutions, for constitutions by their very nature imply a belief in a stable external order, in man's reasonability, and in his ability to formulate and

establish a rational mode of government, grounded in a rational creation. Law is reason, as John Courtney Murray said, which is why we discuss reasons for laws. Ultimately, law is reason because God is Logos.

The anti-rational view not only makes democratic, constitutional order superfluous, it renders it inimical to Islamists as the form of blasphemy they fear the most. Al Qaeda author Yussuf al-Ayyeri (killed in a gun battle in Riyadh, June, 2003) wrote in his last book, *The Future of Iraq and the Arabian Peninsula after the Fall of Baghdad*: “It is not the American war machine that should be of the utmost concern to Muslims. What threatens the future of Islam, in fact its very survival, is American Democracy.” Because democracies base their political order on reason and free will, and leave in play questions radical Islamists believe have been definitively settled by revelation, radical Islamists regard democracies as their natural and fatal enemies.

The demotion of reason at the theological level is Islamism’s connection with modern ideology and its secular demotion of reason, and the subsequent celebration of the use of force. Modern ideology also asserts that the primary constituent of reality is will. This is at the heart of Nietzsche, of course, and his analysis of Socrates and Greek philosophy. Philosophy is simply a rationalisation, an assertion of the will, the will to dominate, the will to power. Nietzsche set up a metaphysical project to make everything the object of the will. The political vulgarisation of this project was the Nazi Party. (As Hans Friedrich Blonk, president of the Reich’s Chamber of Literature, put in 1939: “this government [was] born out of opposition to rationalism.”) The same demotion of reason

took place in Marxism-Leninism. Marx said that reason is an excrescence of material forces. It has no legitimacy. One does not argue with man; one does not persuade people. In order to change man, one must get hold of all the forces of production, change them, and then change man's thinking. Ineluctably, if will and power are the primary constituents of reality, one will, in a series of deductive steps, conclude to a totalitarian regime. There is no other way out of it.

The curious thing is that it does not matter whether one's view of reality as pure will has its origin in a deformed theology or in a totally secular ideology: the political consequences are the same. In fact, as Fr. James Schall has shown, whether the notion of pure will as the basis of reality originates in a deformed theology or in Hegel or Hobbes, the results will be pretty much the same in terms of tyrannical rule. Disordered will, unfettered by right reason, is *the* political problem.

As mentioned earlier, when facing the challenge from the West, many Muslims sought to imitate it. Why, of all things, did they choose as their models the worst of what the West had to offer, fascism and communism? Why, with the exception of Turkey, did they not try to imitate a constitutional democratic order? The answer is that these Muslims were naturally drawn to fascism and communism as more compatible with what they already believed, rather than to a political order that presumes the primacy of reason. These models appealed precisely because they are based upon the primacy of the will and the denigration of reason.

Neither communism nor fascism has worked for the Arabs — because they have not worked for anyone — but the Islamists

have ingested their totalitarian programs and mixed them with their Asharite interpretation of Islam. That is why one can compare the features of these ideologies and even some of the language they use almost exactly. Like both the communists and the Nazis, Islamists see force as *necessary* to affect the transformation that they desire. As Bin Laden's deputy, Ayman Al Zawahiri, announced, "Reform can only take place through Jihad for the sake of Allah, and any call for reform that is not through Jihad is doomed to death and failure. We must understand the nature of the battle and conflict." (Note Zawahiri's frequent references in his correspondence with Zarqawi in Iraq to his colleagues as good "Asharis.") On November 30, 2005, an Al Qaeda tape asked rhetorically, "How can we impose this religion? Can we do that through peace? Can we do it through logic? Can we do it by suggestions and ballots?" Then, the voice answered: "The only way we can do it is by the sword."

Radical Islamists translate their version of God's omnipotence into a politics of unlimited power. As God's instruments, they are channels for this power. Once the primacy of force is posited, terrorism becomes the next logical step to power, as it did in the 20th-century secular ideologies of power, Nazism and Marxism-Leninism. This is what led Osama bin Laden to embrace the astonishing statement of his spiritual godfather, Abdullah Azzam, which Osama quoted in the November 2001 video, released after 9/11: "Terrorism is an obligation in Allah's religion."

The problem today is that the side of reason in Islam is lost. It is not that it is not still there — there are some extraordinarily intelligent Muslim scholars who would like to see a neo-

Mu'tazilite movement within Islam, a restoration of the primacy of reason so that they can re-open the doors to *ijtihad* and develop some kind of natural law foundation for humane, political, constitutional rule. In fact, this work was already begun in the 19th century by thinkers such as Ahmed Khan in India. In certain places in the Islamic world, however, if one dares to say that the Qur'an is not coeternal with Allah, one had better have protection. There are Muslims who will say this, but many of them are in the West. Unfortunately, many of the neo-Mu'tazilites, the ones who want to resuscitate the great tradition of Muslim philosophy, are in the West as well.

The great crisis that has seized the Islamic world poses the question to Muslims: "Can we enter the modern world and also retain our faith?" One answer has been provided by the Islamists and by Osama Bin-Laden. The answer is no: we must destroy modernity and re-establish the Caliphate. The answer of Islamism reveals a spiritual pathology based upon a theological deformation that has produced a dysfunctional culture.

Therefore, the problem must be addressed at the level at which it exists. To say that the West needs to go in and improve the economic conditions in the Middle East in order to drain the swamp of terrorism is, by itself, profoundly mistaken. Terrorists are produced by a totalitarian ideology justifying terrorism. That is its "root cause." If someone had suggested that in order to deal with Nazism one first had to overcome the problem of poverty in Germany, they would be laughed out of school. Yet this kind of thinking is taken seriously today.

The Middle East is poor because of this dysfunctional culture based upon a deformed theology and, unless it can be reformed at that level, economic reform or the development of constitutional political order will not succeed. If one lives in a society that ascribes everything to first causes, one is not going to look around the world and try to figure out how it works or how to improve it. One will submit and do one's duty as one is told to do it. Allah is in charge of everything. To think that the only obstacles to democracy in such cultures are the autocracies that rule them is delusional. It is no accident that the embraced view of a tyrannical god produces tyrannical political orders. Without a different theology, can one have democracy?

Inside the Islamist understanding of revelation, is one authorised at any point to state the fundamental principle of democracy: that all people are created equal? A Nazi cannot say it; a communist cannot say it and, if one speaks only as a radical Muslim, one cannot say it either, because it is not part of the revelation. All Muslims are created equal, but what about the non-Muslims? Those are the dhimmi; they are ruled in a different way. If there is no principle of equality, there is no philosophical foundation for democracy. According to Raphael Patai, a revealing proverb from the Levant states: "Nothing humiliates a man like being subject to somebody else's authority." This is so when there is no rational basis upon which to give one's assent to the authority of another because that authority itself is not based upon reason. It is not based upon reason because there is no recognition of the principle of equality.

As stated at the beginning, the Islamic world is very rich; it is highly variegated.¹² Is there a constituency within the Muslim world that can elaborate a theology that allows modernity? The past glories of Islamic civilization show that it was once able to progress. That progress was based upon a different set of ideas, antithetical to those of the Islamists, who would have been considered heretical then. Today, there are many Muslims who want to, and think they can, enter the modern world, which means modern science, modern political institutions, and also keep their faith. Unfortunately, the ideas gaining traction today are not theirs. That is the crisis. The answer that is sweeping the Islamic world today does not come from people like these. It is from the al-Qaedaists and the neo-Kharijites. As described by analyst Tony Corn (Real Clear Politics, 1/6/06), “In the past 30 years, one particular brand — pan-Islamic Salafism — has been allowed to fill the vacuum left by the failure of pan-Arab Socialism and, in the process, to marginalize the more enlightened forms of Islam to the point where Salafism now occupies a quasi-hegemonic position in the Muslim world.” Alas, Qutb is everywhere. And little is being done to counter this trend.

The transmogrification of Islam into Islamism is bad news not only for the West, but also for the majority of Muslims who have no desire to live in totalitarian theocracies. In their case, numbers may not matter, any more than they did for the hapless peoples of the Russian Empire who suddenly found

¹² It has been outside the scope of this paper to treat this richness in its Sunni and Shiite varieties, in the mystical Sufi tradition, or in the four legal schools of Islam, but to deal rather with the strains within Islam that helped to lay the basis for Islamism.

themselves ruled by a tiny, violent clique of Leninists in 1917. The small, tightly organized, highly disciplined and well-funded groups of Islamists seek to emulate the Leninist success with similar tactics of propaganda and violence. The worse things get, especially in the Arab world, the more appealing the Islamist message becomes as an explanation for the predicament and a program of action to overcome it. For this reason, it is in the Islamists' self-interest that the situation gets worse. In fact, they can help insure that it does.

It is not inevitable that the Islamists should succeed, except in the absence of any strategy to counter them. Muslim leaders like the former president of Indonesia, Abdurrahman Wahid, have called for a counter-strategy ("Right Islam vs. Wrong Islam," Wall Street Journal, 12/30/2005) that would include offering "a compelling alternative vision of Islam, one that banishes the fanatical ideology of hatred to the darkness from which it emerged." He advocates a partnership with the non-Muslim world in a massively resourced effort to uphold human dignity, freedom of conscience, religious freedom, and the benefits of modernity before the juggernaut of Islamist ideology swamps the Muslim world. It is a compelling summons. It has yet to be answered.

Ljubo Sirc: Robert Reilly's effort to disentangle the psychology behind the Islamist aggression is most instructive. The closest I have come to having any thoughts on the influence a religion can possibly have on political behaviour was when I was writing my first doctorate thesis (never completed) on the Nuremberg Trials. The problem arose on how to explain the non-application of the legal principle *nulla poena sine lege* to the National Socialist leaders and their

crimes, since no punishment had ever been decreed for those starting a war or killing people because of their race.

The European Convention on Human Rights has resolved this problem by providing in Article 7, paragraph 2, that the prohibition of punishment without law “shall not prejudice the trial and punishment of any person for any act or omission which, at the time when it was committed, was criminal according to general principles of law recognised by civilised nations”. To put it briefly, punishment of crimes is allowed without written law if that crime is condemned by morals. This was my initial deduction but then I ended up in a court myself and was forced to reflect on punishment without law (even against law) in my own case.

In other words, I was confronted with the question of whether law has to be in accordance with morals and further what was the nature of morals (either supporting law or valid without it). My conclusion was that morals must necessarily be based on reason and that religious morals had a moral-logical quality with which quality Kant's categorical imperative can easily be aligned.

After having escaped communist Yugoslavia, I no longer pursued the problems of the Nuremberg Trials, but continued to be interested in the relationship between moral teachings in different surroundings. It so happens that I landed up at the University in Dhaka in the early 1960s. Not that I had time to go into details of morals as adhered to in Islam, Hinduism and Buddhism, but I was in daily contact with people, primarily students and lecturers, belonging to these religions, and I never encountered behaviour (or statements for that matter),

which could be considered different from what I believed with my Christian background. When it came to precepts of practical behaviour, to me all religions were in agreement.

One could not expect any agreement with rational morals in the political movement of National Socialism. This movement was dominated by *der Wille zur Macht* (the will for power, the will to command), for people who considered themselves superior to others on the basis of their alleged racial origin. Without denying that human beings differ from one other in many ways, there is no perceptible difference that elevates one human being above another. Any pretension to this effect must make the perpetrator, particularly if the perpetrator pretends to have power over the next person's (his 'neighbour') life, deserving of punishment if his immoral pretence is put into practice.

What attracts attention is Lenin's — and Leninists — assumption that they possess knowledge, which entitles them to consider themselves superior to those who do not possess this knowledge or refuse to accept it. While reason, knowledge, deserves respect and acceptance, as far as it goes, there are certainly parts of the world and life that we do not understand and which we may not be able to encompass at all. From this incomprehension it follows that life, as it is, imposes humility on humans and respect for one's neighbours. To pretend that one's understanding of this world is superior to the understanding of others, so he should actually eliminate dissenters must certainly be deemed a crime if implemented.

The surprise is that the condemnation of racialism is almost general, while the pretence to exclusive knowledge is not.

This attitude is the more astonishing, as the collapse of communism in the Soviet Union and Eastern Europe proves that Marxist Leninist ideas are at least dubious, if not entirely wrong. Yet, their apologists say that the intentions of Marxist-Leninist perpetrators were good although their practice was criminal. Even disregarding for the moment the old wisdom that *finis non sanctificat media*, wanting too much good, desiring Utopia, may not be human. Part of our limited rationality must be caution: do not seek better solutions if you cannot be certain that they will be better. Moderation is an important principle in view of our limited rationality. The problem is not just a limited rationality, it is wrong that we can never be entirely certain of knowing all the premises when trying to reach conclusions.

Because Marxists-Leninists have thrown moderation and caution to the winds, their initial aim actually was to achieve a better world. When it became clear that their doctrine did not help to achieve this they still continued this pretence. If one rejects the myth of good intentions and the pretension to some kind of Marxist perfect knowledge, what remains is simply the will to power, the will to dominate.

While racialism and communism are being worn down, a new threat has made its appearance. It is Islamism, a distortion of the Muslim religion, which Robert Reilly explains in theological terms. Islamists proclaim that God's ways cannot be known because God is not bound by any reason or sentiment, but is a Will requiring meek human submission.

The question arises: Will for what? The apparent answer is: God's will as expressed in the Koran. But any text, including

the Koran, requires interpretation and interpretation is by necessity based on reason and logic, here excluded so that we are left with a pure Will. Worse, this pure Will can change so that submission can be expressed by a human being only by killing oneself and as many others as possible.

The Islamist leaders, of course, do not themselves go and kill. For them the will to unlimited power is contained in their ability to order the killing by others and of others. It would seem that such an interpretation of religion is immoral and criminal and requires that all people of goodwill, whatever their beliefs, unite their strength to defeat such distortions.

The distortion may be expected as a consequence of one-sidedness, approaching life only from the aspect of the will. Surely, the will in human beings has to be continued with our capacity to reason as limited as that may be: in order to set aims for actions driven by will. And even reason has to be checked by human sentiments such as moderation and tolerance; in religious terms “love for our neighbour”. Human actions, hence, require the engagement of the whole human being to become reliable.

It follows that the will in combination with reason and sentiment must not be rejected. Its role is to help moral precepts to prevail and to defend human achievements. It will not do to allow crime to succeed. This struggle never ends.

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