



Unravelling the New World Order

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Are Deciding Your Future*

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The Crisis of The European Union *How long before we see a similar crisis in the U.S.?*

by Vaclav Klaus, President, Czech Republic

UNWO Editor's Note:

Vaclav Klaus, the president of the Czech Republic, delivered the following speech to friends of Hillsdale College in Berlin at the Hotel Adlon on June 11. In that address, Mr. Klaus describes the developments that led to the current crisis in Europe. Given the way our government has been pushing us toward the precipice, we may catch up with Europe—in terms of their problems—very soon. Mr. Klaus offers one tiny glimmer of hope at the end of his address: “Maybe seeing Europe’s crisis today will help you in America turn back toward freedom.”

As some of you may know, this is not my first contact with Hillsdale College. I vividly remember my visit to Hillsdale more than ten years ago, in March 2000.

. . . The title of my previous speech at Hillsdale was “The Problems of Liberty in a Newly-Born Democracy and Market Economy.” At that time, we were only ten years after the fall of communism, and the topic was relevant. It is different now. Not only is communism over, our radical transition from communism to a free society is over, too. We face different challenges and see new dangers on the horizon. So let me say a few words about the continent of Europe today.

You may like the old Europe—full of history, full of culture, full of decadence, full of fading beauty—and I do as well. But the political, social and economic developments here bother me. Unlike you, I am neither a visitor to Europe nor an uninvolved observer of it. I live here, and I do not see any reason to describe the current Europe in a propagandistic way, using rosy colors or glasses. Many of us in Europe are aware of the fact that it faces a serious problem, which is not a short- or medium-term business cycle phenomenon. Nor is it a consequence of the recent financial and economic crisis. This crisis only made it more visible. As an economist, I would call it a structural problem, which will not, by itself, wither away. We will not simply outgrow it, as some hope or believe.

It used to look quite different here. The question is when things started to change. The post-World War II reconstruction of Europe was a success because the war eliminated, or at least weakened, all kinds of special interest coalitions and pressure groups. In the following decades, Europe was growing, peaceful, stable and relevant. Why is Europe less successful and less relevant today?

I see it basically as a result of two interrelated phenomena—the European integration process on the one hand, and the evolution of the European economic and social system on the other—both of which have been undergoing a fundamental change in the context of the “brave new world” of our permissive, anti-market, redistributive society—a society that has forgotten the ideas on which the greatness of Europe was built.

I will start with the first issue, because I repeatedly see that people on other continents do not have a proper understanding of the European integration process—of its effects and consequences. It is partly because they do not care—which is quite rational—and partly because they accept *a priori* the idea that a regional integration is—regardless of its form, style, methods and ambitions—an exclusively positive, progressive and politically correct project. They also very often accept the conventional wisdom that the weakening of nation-states, and the strengthening of supranational

institutions, is a movement in the right direction. I know there are many opponents of such a view in your country—at such places as Hillsdale—but it has many supporters as well.

A positive evaluation of developments in Europe over the past 50 years can be explained only as an underestimation of what has been going on recently. In the 1950s, the leading idea behind the European integration was to liberalize, to open up, to remove all kinds of barriers which existed at the borders of individual countries, to enable the free movement of goods, services, people and ideas across the European continent. This was undisputedly a step forward, and it helped Europe significantly.

But European integration took a different course during the 1980s, and the decisive breakthrough came with the Maastricht Treaty in December 1991. Political interests that sought to unify and create a new superpower out of Europe started to dominate. Integration had turned into unification, and liberalization had turned into centralization of decision making, the harmonization of rules and legislation, the strengthening of European institutions at the expense of institutions in the member states, and what can even be called post-democracy. Since then, Europe's constituting elements—the states—have been consistently and systematically undermined. It was forgotten that states are the only institutions where real democracy is possible.

After the fall of communism, the Czech Republic wanted to reassume its place among European democracies. We did not want to sit aside—as we were forced to do throughout the communist era—and European Union membership was the only alternative. Nothing else legitimizes a country in Europe these days. Therefore, we joined the EU in May 2004. However, for those of us who spent most of our lives in the authoritative, oppressive, and non-functioning communist regime, the ongoing weakening of democracy and of free markets on the European continent represents something we did not expect and did not wish for in the moment of the fall of communism.

The most visible European problem today is the European monetary union, which was presented as the most important unification achievement following the Maastricht Treaty. The realization of this monetary union has not delivered the positive effects that—rightly or wrongly—had been expected from it. It was intended to accelerate economic growth, reduce inflation, and protect member states against external economic disruptions or so-called exogenous shocks. It has not worked. After the establishment of the euro zone, the economic growth of its member states slowed down relative to previous decades, thus increasing the gap between the rate of growth in the euro zone countries and that in other major economies. The internal disequilibria—such as trade imbalances and state budget imbalances—became larger, not smaller. And there is no indicator pointing towards a growing convergence in the euro zone countries. During its first decade of existence, a common currency has not led to any measurable homogenization of the member states' economies.

It should have been clear to all, as it was to me, that the idea of a single European currency was essentially wrong—that it would create huge economic problems and lead inevitably to an undemocratic centralization of Europe. To my great regret, this is exactly what has been happening. The euro zone, which comprises 17 countries, is not an “optimum currency area” as defined by economic theory. In a currency or monetary union—which amounts to an extreme form of fixed exchange rates—it is inevitable that the costs of establishing and especially maintaining it exceed its benefits. Most economic commentators were satisfied by the ease and apparent inexpensiveness of the establishment of Europe's common monetary area. In recent years, however, the negative effects of the straightjacket of a single currency have become more and more evident. When good economic weather prevailed, no visible problems arose. But when bad economic weather set in, the lack of homogeneity manifested itself quite strongly.

It is difficult to speculate about the future of the euro. I suppose that it will not collapse, because a huge amount of political capital was invested in its existence. It will continue to exist, but at a very high price in terms of large-scale fiscal transfers—the shuffling around of problems between countries, which amounts to a non-solution—and of low economic growth rates.

The second reason for European economic problems—not specifically European, but worse in Europe than elsewhere—has to do with the quality, productivity and efficiency of its economic and social system. Europe is characterized by a seemingly people-friendly, non-demanding, paternalistic and—in consequence—insufficiently productive economic and social system called *die soziale Markwirtschaft*, or social democracy. This system—with its generous social benefits, weakened motivation, shortened working hours, prolonged years of study, and lowered retirement ages—diminished the supply of labor, both at the macro level and structurally, and led to very slow economic growth.

In Europe, we have witnessed a gradual shift away from liberalizing and removing barriers and towards a massive introduction of regulation from above, an ever-expanding welfare system, new and more sophisticated forms of protectionism, and continuously growing legal and regulatory burdens on business. All of these weaken and restrain freedom, democracy and democratic accountability, not to mention economic efficiency, entrepreneurship and competitiveness.

Europeans today prefer leisure to performance, security to risk-taking, paternalism to free markets, collectivism and group entitlements to individualism. They have always been more risk-averse than Americans, but the difference continues to grow. Economic freedom has a very low priority here. It seems that Europeans are not interested in capitalism and free markets and do not understand that their current behavior undermines the very institutions that made their past success possible. They are eager to defend their non-economic freedoms—the easiness, looseness, laxity and permissiveness of modern or post-modern European society—but when it comes to their economic freedoms, they are quite indifferent.

The critical situation in Europe today is visible to everybody. It is not possible to hide it. I had believed that this spectacle would be a help to the cause of political and economic freedom in Europe, but this is not proving to be the case. Of course, with the way your American government has been going, you might be able to catch up with us—in terms of our problems—very soon. But you are not as far along yet. So maybe seeing Europe's crisis today will at least help you in America turn back toward freedom.

Vaclav Klaus is the president of the Czech Republic, and has served twice as its prime minister. He was born in Prague in 1941, and holds his doctorate in economics from the University of Economics in Prague, where he still teaches. He also studied in Italy in 1966 and in the United States in 1969.

In 1989, large events began to unfold in the world which were terribly significant in the native country of Vaclav Klaus, who had begun his career as an academic, worked for a long time in a state bank, and eventually returned to the academy. In the month in which the prospect of freedom came in the Czech Republic—or Czechoslovakia as it was then—he was immediately appointed its finance minister, in which role he set out to restructure his nation's economy.

Mr. Klaus is a member of the Mont Pelerin Society, a society dedicated to freedom that was founded in 1947 by people like Friedrich Hayek and Milton Friedman. Lately he has been unique in the context of European politics—a person in high authority who is critical of the steady advance of centralized power in the European Union, and of the absence of accountability in its government to the peoples who are ruled by it.