

Speech by President Václav Klaus "Europe: The Shattering of Illusions"*

Many thanks for organizing this gathering and for making it possible for me to introduce the book "Europe: The Shattering of Illusions" (Bloomberg, 2012) to the potential British readers.

The book was originally published in Prague last December in Czech language, in Bulgaria in February, in Italy in August, the German edition was presented two weeks ago in Vienna and the Spanish edition will be launched in Madrid next Monday.

The book reflects my frustration with the current situation in Europe. It discusses the European institutional developments since the Second World War till the beginning of the Eurozone debt crisis. As the most important I consider the chapters devoted to the polemics with the excessively optimistic expectations of the economic benefits of territorial integration (and centralization) as well as to the discussion of the undemocratic consequences of denationalization and communitarization of Europe.

All the available evidence – both the economic data and the economic measures implemented up to now – suggests that the economic future will not be easy for those of us who live in Europe together with our families, children and grandchildren, and have, therefore, genuine, not only academic interest in its positive future.

My country, the Czech Republic, is part of Europe, a member of the European Union, and a non-member of the Eurozone. More than 80% of our exports goes to Western Europe, to a region which undergoes **a long time-lasting economic stagnation and an acute sovereign debt crisis**. Even keeping our own freely floating Czech crown we cannot disconnect ourselves from the movements of the rest of Europe. The Czech Republic – as a textbook case of a small open economy – needs a healthy economic growth of our main trading partners to be able to grow. This is, regrettably, not the case.

This didn't fall from heaven, this is not an accident. This is the result of **the European economic and social system and of the European Union institutional arrangements. They both are a fundamental obstacle to any further positive European development, an obstacle which cannot be removed by cosmetic changes or by more rational short term economic policies.**

The first part of the problem I see in **the European economic and social system itself**. It is more than evident that the overregulated economy, additionally constrained by a heavy load of social and environmental requirements, operating in a paternalistic welfare state, cannot grow. This burden is too heavy and the incentives to a productive work are too weak. **If Europe wants to grow, it has to undertake a fundamental transformation**, a systemic change, something we had to do 20 years ago in our part of Europe.

* House of Commons, Westminster, London, 27th November 2012

The second part of the problem I see in **the European integration model**. The artificial, absolutely unnecessary centralization, harmonization, standardization and unification of the European continent based on the concept of "ever-closer Europe" is another fatal mistake.

As we all know it found its "climax" in **the monetary unification of Europe. Its failure was inevitable**. Its consequences –

especially for economically weaker European countries which were used to undergo unpleasant, but adjustment-bringing devaluations of their currencies repeatedly in the past – were well-known in advance as well. All economists who deserve to be called economists had known that Greece and some other countries were doomed to fail having been imprisoned in such a system.

The benefits – promised as a result of accepting a common currency – never arrived. The assumed increase in international trade and in financial transaction was relatively small and was more than offset by **the costs of this arrangement**.

In good weather (in economic sense), even the non-optimal currency areas could function (as all kinds of fixed exchange rate regimes did for some time). When bad weather came – the financial and economic crisis at the end of the last decade – **all the inconsistencies, weaknesses, inefficiencies, discrepancies, imbalances and disequilibria became evident** and the monetary union ceased to properly function. This can't be considered a surprise. **In the past all fixed exchange rate regimes needed exchange rates realignments sooner or later** which is another argument found in every elementary economic textbook.

The expectations, better to say wishes or dreams, that a very heterogeneous European economy would be made homogenous by means of monetary unification were proved to be wrong. **The European economies have diverged, not converged since the introduction of euro**. The elimination of one of the most important economic variables – of the exchange rate – from the existing economic system led to an inexcusable blindness of politicians, economists, bankers and all other economic agents.

I consider it irrational when discussing current European problems to concentrate on Greece or any other country in the European South. **Greece did not bring about the current European problem, Greece is the victim of the Eurozone system**. Greece made just one tragic error – to enter the Eurozone. Everything else was its usual behavior.

Greece's degree of economic efficiency or inefficiency and its propensity to live with a sovereign debt was or should have been well-known to anyone. To let Greece to leave Eurozone would be the beginning of a long journey of this country to a normal economic development. The Greeks hopefully already understood that "one size does not fit all" and I only wish the same would be understood by leading EU politicians. I don't see it, however.

The European Union decision-makers do not want to see it. Their way of thinking is based on **an almost communist type of reasoning: economic laws do not exist, politics may dictate economics**. People like me were raised in an era

when such a mode of thinking was dominant in countries of Central and Eastern Europe. Some of us dared to express our disagreement with it already in the past. We were considered enemies then, we are considered enemies now.

There is **time for a fundamental decision**: should we continue believing in the dogma that politics can dictate economics and continue defending the common currency at whatever costs or should we finally accept that we have to return to economic rationality?

The answer to such a question given by the overwhelming majority of European politicians has been until now **YES, we should continue**. Our task is to tell them that the consequences of such a policy will be higher and higher costs for all of us. At one moment, these costs will become intolerable and unbearable. **We should say NO. We find ourselves in a blind alley** and in such a case the only possible way out is the way back.

As I said, **what we need is a fundamental transformation of our thinking and of our behaviour**. Europe has to undertake a systemic change. Coming to such a decision needs a genuine political process, not the approval of a document prepared behind closed doors by a group of EU bureaucrats. **It must arise as an outcome of political debates in individual EU member countries**. It must be generated by the people, the "demos" of these countries. (There is no demos in Europe, there are just "inhabitants" of Europe.)

We live in a crisis. But crisis is – in Schumpeter's definition – **a process of creative destruction**. Not everything can be saved and maintained. Something must be destroyed or left behind in this process, especially the wrong ideas. **We should get rid of utopian dreams, of irrational economic activities and of their promotion by European governments**. Part of this implies that even some states must be left to fall. The opponents of such positions keep saying that such a solution would be costly. It is not true. The prolongation of the current muddling through is more costly. The costs the Europeans are afraid of, the so-called sunk costs, are already here!