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Rules and peace:  
an Eastern European perspective

submitted by:

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## ***Introduction***

I first encountered Friedrich August von Hayek during my years of high school in Sofia, Bulgaria when I started reading about politics and political philosophy. Indeed, in Eastern Europe Hayek is in my view much more popular among young people than in the rest of Europe, certainly due to our prior experience in the last half of century. After my coming to Germany, for a long time I did not hear the name “Hayek”, which is to some extent surprising since when studying Economics, one expects that the professors get you acquainted with the ideas of Nobel Prize winners. Austrian Economics is, however, completely off the mainstream path, and that not only in Hamburg. Why am I writing that? Because I want to stress that my knowledge of Hayek is rather self-taught and to some extent fragmented. Still, I decided to take part in the current Hayek Essay Contest of the Mont Pelerin Society, competing with people who are definitely much more familiar with the relevant literature. The reason is my own perception of Hayek: when I read something by or about him, I very often feel reminded of the arguments I was sharing with my friends in the endless political discussions in Bulgaria. Thus my view of Hayekian ideas is certainly an idiosyncratic, Eastern European one but I hope that this particular perspective is worthwhile contributing.

## ***Economic integration***

When reading the essay topic, what first occurred to me is the concept of economic integration. Integration is for me the intertwining of commodity, financial and labour markets of regions, i.e. I would prefer a broader approach when discussing this topic and not only restrict myself to trade, which is the solely integration of commodity markets. Why? First because in my PhD work I am engaged in analysing interdependent markets and the policy implications that arise from them and see that often a partial analysis of a single market type does not lead to the right conclusions. Second because it is an Austrian position that the stability of an economy and its cycles crucially depend on the monetary subsystem, i.e. the financial markets. And third because at the beginning of the 21<sup>st</sup> century, trade is still a major driver of integration but, unlike 40 years ago, not the only one: financial transactions and labour migration are also of great significance in the current wave of globalisation.

Why are countries integrating their economies? There are numerous reasons for that, and I would like to start from the economic motives. Integration brings about a larger commodity market for the incumbent enterprises, thus allowing them to produce more efficiently. A larger market is also more interesting for new entrants so that in the mid run the market becomes more and more competitive, leading to better products and lower prices for consumers. Integrated labour

markets allow everybody to freely migrate to the most suitable job-locations combinations. Integrated financial markets allow cheaper financing for enterprises, giving them a competitive advantage over companies in non-integrated economies. From a macroeconomic perspective, an integrated economy responds in a more flexible way to external shocks.

The above list is undoubtedly overwhelming. I have personally greatly profited from all these aspects of the integration of the Bulgarian economy into the European and global markets: the goods I could purchase became better and some of them also cheaper, financing my studies abroad via debt suddenly seemed feasible, and above all: I could migrate to another country where I evaluate my prospects higher than at home. But is that the mechanism and motivation behind the tiresome and painful road of a small country like Bulgaria into a larger structure like the EU?

In my opinion, only partially. Of course the striving of a poor country for prosperity is crucial. But I believe that these profits have been to some extent, using one of the major terms in Hayek's legacy, an unintended consequence. The primary motivation was a different one: it was peace and re-belonging to a civilization from which we had been torn apart for half a century.

### ***Civilizational choice***

1996 was a very important year for my country. Bulgaria was at the brink of collapse: banks went bankrupt, inflation was breathtaking, the currency became close to worthless. In this turmoil, the presidential campaign took place and the anti-communist candidate, Petar Stoyanov, won a landslide victory. This was the beginning of our second revolution and the time when I read Hayek's "Road to Serfdom" the first time. How did Petar Stoyanov win? It was not solely due to the vast dissatisfaction with our post-communist elites. Mr. Stoyanov set his campaign under the slogan of the "Civilizational choice". What he meant with this statement was to become the core of Bulgarian policies, foreign and internal, for the next 10 years. He actually reminded us that Bulgaria was always a part of the European civilization and we must do our best to join this community again, whatever this might cost us in the short run.

This is not only a Bulgarian experience. Germany 60 years ago poses a very similar example of integration where economics was not more than a by-product of political intentions directed in a different direction. Konrad Adenauer was not a liberal, neither in the European nor in the American sense of the word. He did not know too much about economics and integration theories. Still he was the spiritus rector of the European integration process by founding the European Coal and Steel Community. His biographers are unanimous that it was not the prosperity of the metallurgical sector that he had in mind but rather a way to integrate his fellow

countrymen into a structure that might, in the course of time, re-educate them and appease their belligerent spirits. Well, it turned out to be a success story, both in the political and the economic aspect.

### ***Integration and rules***

In the above we already have the standard economic definition of integration which would certainly be the crucial one if integration was envisioned by politicians on the grounds of such economic reasoning. In the section about the civilizational choice of charismatic politicians, however, I asserted that economics is often not the primary driver of the integration momentum of a country. That is why we need another definition which better corresponds to this geostrategical motivation, and I would like to propose the following: integration is equivalent to successively surrendering significant parts of your power to someone else. Previously the rules of your society and economy were partially set by cultural evolution and partially by political decisions of the country's political establishment. Now, in the process of integration, both the sets of rules coming from evolution and the ones coming from discretionary political decisions can be overhauled, for the good or the bad, by the newly integrated community where the own country is just one of at least two subsystems.

The first example comes, not surprisingly, from Bulgaria. In the hyperinflation period mentioned above, our central bank, up to that point the autonomous maker of monetary policy, simply failed regarding inflation management, nullifying billions of savings of people who were already poor. The population was exasperated. This frustration would, under normal circumstances, have brought about at most the resignation of the governor of the bank but not much more. Bulgaria was, however, already a part of the global financial institutional framework, among others dependent on IMF funding to bridge the acute crisis. And here came the rigorous change of rules which would not be possible without being integrated: the IMF effectively closed down our central bank. A new institution, a so called Currency Board, was implemented on a very brief notice and thus Bulgaria stopped doing monetary policy itself since the board has an in-built automatic money-supply mechanism. Inflation dropped from more than 1000% to about 10%. The rules changed dramatically from one day to the other and a higher entity (here the IMF) set a new paradigm of rules which would be impossible without being at least partially integrated into the global financial architecture.

Another example of integration as a change in the rule-setting entity is the competition policy of the European Union vis-à-vis the member states. There are plenty of reasons to be upset about what Brussels is doing, but regarding competition policy I am quite confident that the EU role is

an absolutely indispensable one. An integrated commodity market needs an integrated competition policy which cannot be performed by individual countries. So all countries had to surrender power in this policy field to Brussels which designed its competition policy in a much more stringent manner than e.g. France previously. Again integration changed the rule setter and thus the rules significantly.

### ***Less democracy through integration?***

Who are, however, the new rule setters? In the one case it was IMF bureaucrats in Washington, in the other the EU bureaucrats in Brussels. In both cases it seems as though the new economic order which has come via the new rules is a regime under which the citizens, who for me as an individualist are the principals, have less power over the decision-making process. An individual Bulgarian can hardly influence a person in far-away Washington, the same with a normal Hamburg citizen vis-à-vis Brussels.

But is democracy what I as a libertarian am maximizing? Well, I think not. Democracy is a good procedure of taking collective decisions. But this is, of course, only second-best since it is still a collective decision where the minority's preferences do not materialize. I would prefer, following e.g. Friedman's "Capitalism and Freedom", a system where collective decisions take place only when absolutely necessary, i.e. as seldom as possible. What is to be maximized is individual liberty.

And that is precisely what is taking place in the evolution of the new economic order. In the examples above, the individuals get an inflation-free marketplace and an increasingly competitive marketplace, respectively, so that its own opportunities for economic actions are sizably enhanced. They obtain a marketplace where prices, both due to the subdued inflation and the higher degree of competition, reflect much better the relative scarcities in the economy. Thus entering the market for the "acting man" of Mises' "Human Action" becomes a more and more attractive option since he can much better make out niches where he can make use of the mistakes of previous entrepreneurs. This is only possible when market prices reflect the real structure of the interlinked market system.

To summarize: yes, we might get less democracy, but integration brings about more individual liberty, which is what actually matters.

## ***Integration or clash of civilizations?***

The analysis up to this point was a rather occidental one. I think at this point we should leave this perspective for a moment since if the new order of global integration is to be tested, we need a broader geographical view.

In the above argumentation, I assumed that the civilizational choice of the many is the driver to integration. But what if this civilizational choice is not there? When we look at e.g. the Arab countries, large parts of their populations define themselves politically precisely through a rejection of pertaining to what they perceive as a US-lead world. At first glance, my Bulgarian experience seems to fail here. The interesting thing about Bulgaria is, however, that my country is situated at the brink of the two civilizations Islam and Christianity which, according to Samuel Huntington, might clash in the near future. Thus, viewing the globe through a Bulgarian lens has an additional advantage apart from the post-communist experience: we have on top really interesting neighbours, especially one: Turkey.

Turkey is for me the perfect example of a country which is steadily going for integration without an invariantly clear civilizational choice. It has its Atatürk heritage which is clearly a European one but which is guarded by an army having far too much power for the standards of any liberal constitution. It is on the one hand heading for an EU membership, on the other it is governed by an Islamist party which some years ago was proposing integration with fellow Muslim neighbours. Very occidental boomtowns like Istanbul, Ankara or Izmir are surrounded by a deeply oriental countryside.

Nevertheless, Turkey is a success. Independent of what it wanted at different time stages, it desires one: pertaining to the global economy via regional integration, be it with its Western or Eastern neighbours.

What can be learned from this brief case study? In my opinion the lesson that Turkey teaches us is that the European integration model is exportable. More distant countries can either in future join the EU, or they can open up own small “EU-clones” with their neighbours. The regional integration which would ensue is for me a first step to an interregional and later on global integration. Once individuals see the advantages of leaving autarky, they will want more of integration. “L’appétit vient en mangeant”, as the French say. Thus the truly integrated regional economic blocs will be the entities of the further integration stages. And countries like Turkey would play role of the bridge, being related to both sides.

## ***Winners and losers of integration***

The scenario developed up to now runs as follows: integration through trade as well as capital and labour flows is driven from both political and economic motives, where the proportion of political vs. economic motivation varies from region to region. We end up with some larger subjects where the individual might have less political but certainly more economic power than previously.

What are the possibilities of further development of this new order? Well, from today's perspective after 50 years of integration in Europe, we have can make some Hayekian pattern predictions without too much pretence of knowledge. The question to be answered is: are there only winners or are there winners and losers?

I believe that the latter is the case. Different trade theories predict different things about the distribution of the benefits of integration, but this is in my opinion not the crucial point. Much more interesting is the fact that even if all regions gain when compared with the autarky state, there will be invariably an uneven distribution of the outcomes. Regions like Hamburg might get an additional growth impulse of e.g. 15% in ten years, whereas my home city of Sofia might get 30%: both are much better off, but will Hamburg perceive itself as a winner? I doubt it. People tend to compare themselves not so much with their past since our sensory capacity is limited; it is easier to compare yourself contemporaneously with your partners.

But why should we care about equality? Indeed, economists seldom do. I think that in the context of rule-setting through integration, distribution may be of significant importance when looking at the phenomenon dynamically. The problem is that the losers are not unlikely to start building up coalitions to start resetting the rules to their favour. This can be clearly seen at the example of the discussion about the tax regime evolution in the EU. The countries which are not willing to do painful reforms like Germany and France and thus continually lose competitiveness, start threatening countries like Slovakia or Estonia, very much in favour of tax competition, that the big EU countries will start pushing tax harmonization in the union.

So having winners and losers is a seemingly inevitable problem. Is integration thus doomed to failure in its later stages?

### ***Convincing the middle class***

To ban the serious threat of illiberal responses from the relative losers of the integration process, we have to fight a constant battle. I remember reading last year the new Bulgarian edition of Hayek's essay "The Intellectuals and Socialism" with a preface by Sir Antony Fisher. He recounted his first conversation with Hayek which inspired him to found the Institute of Economic Affairs and where Hayek advised him that classical liberalism can only prevail if we succeed in convincing the opinion makers in a society as well as its middle class.

For me this lesson is at least as valid today as it was 1945. Yes, some regions or countries might temporarily perceive themselves as losers of the new global order. The tricky issue is to make them see why they are sliding into that position. It is of course easier for socialist demagogues to say that it is the integration's fault, that the whole project is the often quoted race to the bottom. Well, we as libertarians must constantly convince society of the opposite. Independent think tanks like the IEA have an indispensable role in this fight. Both the media and the normal citizens must be addressed by campaigns or smaller initiatives like seminars and be taught what Mises would call "basic economic reasoning". These mechanisms of economics should encourage them to believe in the power of entrepreneurship and competition and help them find the right (i.e. libertarian) answers to the problems of their lagging region. And what are these answers?

### ***Successful policies in an integrated world***

I believe it is not an easily attainable goal to become and stay successful in the integration scenario described here. The reason for that is that there are more and more hungry people entering the scene. Until 1989 in Europe, the marvels of capital accumulation could accrue primarily to the few countries to the west of the Iron Curtain, whereas today twice as many people compete for the capital. These people have historically a different, i.e. less socialist, attitude towards the state and thus require less costly welfare policies than their neighbours e.g. in Germany or France. So what should Germany do?

I would try to differentiate between a long-term and a short-term goal. The long-term goal would be to try to influence the preferences of the people here away from socialism. This is, however, really a very challenging task, judging from my day-to-day conversations with my German friends and colleagues. The 1968 "revolution" has imbued so much socialist thinking in them that it might take really long to gradually eradicate it. Despite that this long-term goal must be pursued with enthusiasm and finesse.

But what to do in the short run? As an economist, my function is (at least in the short run) to respect the preferences of society and to show it the most efficient way how to achieve the goals resulting from these preferences. If the German citizens want to keep up their welfare state, one could try to help them achieve such a superior productivity level vis-à-vis e.g. Bulgaria that they can afford having the welfare state.

So what would an economist involved in such a policy consulting mission do? Well, actually “preach” the same as his long-term goal: more liberalism! How else can a country reach high productivity? The words themselves, by the way, betray the collectivist (macroeconomic) reasoning behind them, but a collectivist order has seldom created a booming economy.

Thus the only successful policy, in the short or the long run, remains the classical liberal solution for prosperity: more trade, lower taxation, education aimed at entrepreneurship, labour markets that do not deter growth with their rigidity, removing barriers to entry in commodity markets etc.

### ***“A universal peaceful order of the world”***

Is the model of integration derived in the preceding sections one that is leading to “a universal peaceful order of the world”? Yes, I believe it is and would like to show it in the last lines of this essay.

What is its universal character? The universality comes from the dynamics shown in the section about Turkey. I believe that the new rule-setting integration will eventually extend from a regional to a global phenomenon since societies that might at first be willing to give away power only to a regional unit will feel the advantages of integration and go for more of it. This is also the more likely scenario because integration into the global institutional framework would not be tackled by the individual countries but via the integrated regional units which would have more power to at least partially endogenize the rule-setting in the new system.

But why does integration lead to a peaceful world? More than 200 years ago, Kant wrote in his essay “Perpetual peace” that democracies do not wage wars on each other. He asserts that when citizens actively participate in the collective decision-making process, states will be much less prone to attack one another. A similar reasoning is even more valid for a world where trade, or more generally integration, is ubiquitous. In such a world, the power of the individual government is weaker because it is confronted with self-confident, prosperous citizens who profit from the integration process. And these citizens have a lot to lose in the case of a war: in a world with omnipresent weapons of mass destruction, a war is not a way, like e.g. in the mercantilist age, to enlarge one’s capital stock by infringing on the neighbour’s wealth, but is

rather a scenario where both my and his capital will be destroyed. Thus the citizens strictly oppose any armed conflict. The rules of trade (e.g. respecting the partners in overseas or studying different tastes of customers abroad in order to produce the right goods) have brought the affluence to the citizens and they realize that if these rules are broken, the flow of prosperity definitely will suddenly cease. Thus trade seems to be the best peace-keeping tool of global scope at our avail.

### ***Conclusion***

The aim of this essay was to show through an Eastern European perspective how the rule-settling phenomenon integration comes about, what impact it has on the political systems and that a permanent battle is to be fought for protecting the fruits of integration from destructive influences. Above all, my purpose was to show that it is a medium of prosperity for the individuals in the countries involved and that it thus secures peace.

One question remains, however, unsolved. Why is our world, after millennia of cultural evolution, still such an unstable place with so many conflicts and so large regions with so little integration? There seem to be some counteracting forces that constantly bring the system off its track to stability and equilibrium. What could these forces be?

In my opinion, the reason is concentration of power in the hands of few, occurring both in the economy and in the political system of a country. Economic power is the power of monopolies, cartels, unions or any other entity that has considerable bargaining power. Political power can be observed, of course, in dictatorships, but also in political systems where the relationship between the voter and the political establishment gets loose. It becomes especially dangerous and potentially destabilizing when economic and political power start to re-enforce each other, like in Germany in the 1930ies. In my opinion one of the core messages of Hayek's "Constitution of Liberty" is that a liberal state is one that sustainably divides power. If this is achieved, the supremacy of the individual as citizen and consumer is guaranteed and, paired with integration, such a society is on a stable way to prosperity.

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