

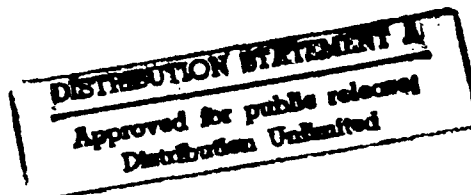
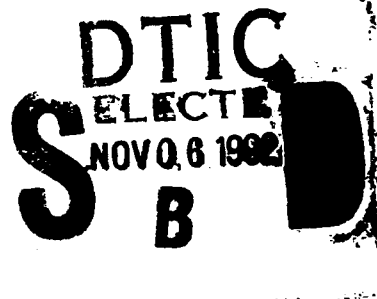
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A RAND NOTE

Western Governmental Assistance to
Eastern Europe: The First Steps

Steven W. Popper



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**Western Governmental Assistance to
Eastern Europe: The First Steps**

Steven W. Popper

**Prepared for the
United States Air Force
Agency for International Development**

RAND

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PREFACE

This Note prescribes a policy of aid to Eastern Europe from Western governments. To provide a perspective from which to view specific efforts by the U.S. Government, the Note assesses Western assistance as an integrated effort coming from foundations, international agencies, and private commercial interests, as well as from governments and their agencies.

Completed in early 1991, the Note is one product of ongoing research on U.S. policy toward change in Eastern Europe sponsored by the Air Force and conducted under the National Security Strategies Program of RAND's Project AIR FORCE. Supplemental funding was provided by the U.S. Agency for International Development. The Note will be of interest both to a lay audience and to policy professionals with an interest in the transformation of Eastern Europe and in the potential role of the West in aiding the process.

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SUMMARY

The successful transformation of Eastern Europe to democracy and to market economics is not assured. Regional stability will depend upon resolving the general economic crisis. This makes the transformation process an object of policy interest for the West.

The economic crisis in Eastern Europe stems from the inability of national economies to make efficient use of resources. The solution lies in the thorough transformation of economic systems. The crisis is aggravated by a legacy of debt. Clearly, these debts may be alleviated by direct resource transfers; their systemic causes may not. Eastern Europe needs assistance, not aid. Large aid grants have the potential to mitigate stock problems, the symptoms of crisis, but not the systemic problems that cause the stock problems.

Reform must be implemented as quickly as possible. The essence of the reform process is to arrive at the point where the momentum of transformation overbalances the inertia of the past. A prolonged reform may reduce the short-term pain while the cumulative suffering mounts with no ultimate payoff.

A program for the radical transformation of a Soviet-type economy must draw on a series of wasting assets. Foremost is the initial store of optimism, hopefulness, and goodwill of the civil population. The worst thing is to waste time, to fritter away such assets with simplistic policies, labeled fundamental reform, which do little more than probe at underlying problems. If the process is slow, individuals will react to uncertainty by drawing upon their experience. Gradual reform does not support a break with the past.

Western assistance will do little more than assuage the consciences of the donor governments if it permits transformation to be postponed. Even if a government sets out on a reform course, institutional drag and the tendency toward "levelling," resulting in resource transfers from apparent profit generators to losers, are difficult to eradicate, especially in a period of concurrent political transformation. Assistance must not abet this predisposition. Resources intended to improve some aspect of the economy should not ultimately buy time for sectors contributing nothing, or less than nothing, to national income. Still, short-term Western assistance could help these economies over the initial period of transformation.

Gifts may alleviate certain debts, but will not necessarily help overall transformation. **Aid of any significant size must be predicated on a commitment to fundamental reform by each potential recipient.** This restriction sounds ungenerous, yet it is a

requirement for ensuring that primary attention is given to treating the causes of malaise, not just the symptoms. The aid must be contingent on establishing a new set of institutions and legal relations, not on demonstrating successful transformation. The actual transformation process is certain to surprise. Mechanisms are needed to make the midcourse corrections that will be required.

The requirements of prudence and contingency imply a need for coordination, the barriers to which do not arise solely on the Western side. Some barriers are attributable to the suddenness of change and confusion on the part of the new governments, which are unable to deal consistently with Western partners. While coordination seems desirable, delay of assistance to await appropriate conditions will miss the current opportunities.

The answer to the coordination conundrum lies in obviating the need for specific assignment of tasks to potential donors. **Coordination might follow naturally if agreement on general roles is reached.** International institutions, e.g., the International Monetary Fund (IMF), Western governments, and private business and philanthropic interests have roles to play.

International institutions, because of their limited charters and lack of political agendas, are best suited to coordinate assistance to achieve macroeconomic stabilization. **For political reasons, Western governments are unlikely to be effective in pressing these countries to stay an austerity course.** It is best for all if they leave the lead role for initial implementation of stabilization to international bodies like the IMF.

Private Western capital has the potential to provide substantial financial inputs, aid privatization, and offer technical assistance. Direct foreign investment will be opportunistic and carefully targeted. The more reason investors have to believe that transition to a functioning market economy will succeed, the greater will be the volume of long-term investments. In the absence of confidence in the transition, investors will tend to focus on gaining short-term advantage from existing economic disequilibriums. Therefore, though not formally coordinated with the stabilization process, foreign investment will be tied to the success of emplacing well-crafted reform packages.

Assistance administered directly by donor governments is the most problematic. Their behavior may be influenced more by political interests than by purely economic considerations. Coupled with the size of their resources, this propensity makes them more susceptible to actions with potentially deleterious consequences for the recipients.

Western governments may avoid many pitfalls if they accept an additional set of rules. They should classify initiatives as either those to be pursued initially and at the earliest opportunity or those implemented later, during the course of reform.

The first class is directed toward skill building and reformulating the institutions of East European economies. These efforts will have minimal budgetary effect on either donor or recipient. Their hallmark is speed. All interests will be served if these initiatives are pursued as soon and as extensively as local governments will permit. Characterized by great diversity and a minimal need for coordination, these early initiatives could easily be undertaken by private groups.

The second group consists of larger programs, often to improve the physical infrastructure and so to help clear several of the region's debts. These will dispose of significant resources and should be implemented in a manner consistent with the principle of contingency: They should be tied to specific indicators of reform. The problem with large-scale lending is that so much is at stake that no one can afford, politically or economically, for individual efforts to fail. Such high stakes lead to delay and an excess of administration. If employed too early, the program may address the wrong needs, e.g., shortages stemming from unrealistic pricing or distribution problems.

Large-scale assistance runs the risk of providing resources sufficiently large to tempt delaying fundamental transformation. Whereas the hallmark of small-scale initiatives is speed, here the hallmark should be "contingency," with each successive stage triggered by the meeting of targets.

Immediate Western assistance should target a core concern: persuading the people of Eastern Europe that democracy will serve their long-run interest better than will even the most enlightened dictatorship. The best support for an emerging democratic system is a wealth-generating local economy. Early Western efforts toward this end should concentrate on education.

Even the early-assistance programs must follow certain rules. First, they should **avoid the creation of new bureaucratic structures.** These cost time and money and erect barriers of intermediation. Second, the early programs should **train the trainers.** Training is the best way to leverage aid. Third, programs should **project a strong predisposition to long-term relationships rather than short-term consultancies.** The latter are more likely to waste money, less likely to have lasting effects or contribute to synergy, and more likely to attract personnel who will perpetuate off-the-shelf programs that are less likely to serve needs based on analyses of the local situation.

While locally based programs are to be preferred, out-of-country training has one advantage. Eastern Europeans tend to rely on custom, the dead hand of what they "know" to be the accepted way to do things. In some areas, training in the donor country would better convey other ways of achieving the given end.

Areas in which specific programs and program elements would meet the most pressing needs of the recipients include local government, professional exchanges, parliamentary support, banking, press, legal services, business, equity markets, environment, educational support, accounting and enterprise organization, retraining, and scientific exchanges. **The U.S. Support for East European Democracy (SEED) Act serves as a model for immediate action by Western governments. These governments should stimulate private initiatives, facilitate contacts between their citizens and those of Eastern Europe, provide expertise on the construction and rehabilitation of institutions, and help to build the skill types needed for the successful transition to market systems.**

ACKNOWLEDGMENTS

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I. INTRODUCTION

The old order in Eastern Europe is gone. Profound disarray seems likely to prevent the former institutions of power from playing a significant part in reshaping the region. Yet, the survival of the successor regimes and the stability of individual nations are not assured. To a great extent, domestic political consensus and institution building, national security, and even regional stability will depend on resolving the economic crisis facing each nation in the region. This dependence makes the successful resolution of the economic crisis an object of policy interest for the West.¹ The question of what the West might do actively to aid the process naturally arises.

This Note considers the question of the West's role in normative terms. After providing a context for discussing the general phenomenon of economic assistance, it presents a view of what Western governments in particular can and ought to do during the earliest stages of transforming the economic realities of Eastern Europe. It also indicates the need for serious consideration of what the limits to the potential role of Western governments might be.

The Note presents a single strategic framework, neither authoritative nor comprehensive, for discussion and assessment. The central thesis is that while most effort will have to come from the Eastern Europeans themselves, the West also has a role in supporting local efforts. Stabilization and direct investment should be carried out largely by players other than Western governments. Individual initiatives from private commercial and noncommercial interests could be decisive in several areas. Yet, the need for institution building remains; Western governments are best poised to contribute to this aspect of political and economic transformation.

¹"West" is used in the political sense to include Japan, Oceania, and such potentially influential nations as South Korea.

II. THE ECONOMIC CRISIS OF EASTERN EUROPE

The countries of Eastern Europe would not naturally be counted in the ranks of the impoverished or underdeveloped. They are, in fact, medium-income countries relatively well endowed with human, material, and capital resources, and they have traditionally exhibited high levels of saving and investment. The origin of the region's general economic crisis lies not in a lack of domestic resources *per se*, but in the inability of the economic systems as they existed in the past, and largely continue to exist, to make efficient use of those resources. The solution to the crisis faced in each country must lie not simply in the reform of existing systems, a process already under way, at least nominally, for more than 20 years in some countries, but in their thorough transformation.

This systemic, or "flow," aspect of the general economic crisis underlies the general economic malaise, and it must be addressed. However the crisis is also aggravated by problems of a "stock" character.

Forty years of Soviet-style socialism have left a series of debts as a legacy. The most obvious, if not the most preponderant, is the debt owed to foreigners. While the debt is tractable in most countries, its accumulation was the first significant intrusion of reality into the economics of illusion holding sway throughout the region. East European leaders were surprised by their inability to translate borrowed funds into assets able to yield productivity gains and subsequently exports to service the debt. Though foreign debt is a major issue only in Poland, Hungary, and Bulgaria, it provides a paradigm for visualizing several forms of debt currently weighing on these economies.

Only a handful of these legacies, or stock problems, can be mentioned here. Among these are the debts owed the environment, the debt owed the capital stock,¹ and the debt, falling due in 1989, which played the largest role in bringing the regimes down, one after the other—the debt owed the civilian population of each country as manifested in goods shortages and the proliferation of monetary imbalances.

Clearly, these stock problems may be alleviated by resource transfers; the flow problems may not. The bifurcation of the general economic crisis and the dynamic connections between its two aspects frame the environment within which Western assistance must occur. Early on, the Eastern Europeans turned to the West for help,

¹Never intended for excellence but rather to meet the output goals of what was essentially a monopsony, namely the state planning agency as an arm of the political leadership, the capital stock is old both in age and in terms of technological vintage. Enterprises, industries, and entire nations will find it difficult to escape the legacy of their past mediocrity now that they are being asked to earn their living by competing on world markets.

and the West demonstrated its willingness to provide the means, if in more limited measure than some in the East had hoped.

Thoughtful Eastern Europeans will point out that what they want from the West is assistance, rather than aid in the form of block grants and resource transfers, which could be misused. Grants and transfers run the danger of creating a new bureaucratic structure that would absorb a good share of any such resources. The greatest danger, however, is the potential for large grants of aid to mitigate some of the stock problems, which are primarily the symptoms of crisis, at the expense of solutions to the systemic, or flow, problems, which are its cause. The greater need is for assistance to put into train a fundamental transformation of systems.

Economic and political transformation will mean in practice erecting new institutions and redrafting the old to accord better with the needs of contemporary East European societies. The balance of this Note will explore how Western assistance may be used to help create or strengthen these institutions without prolonging the existence of those whose useful lives have ended. The balance between the positive and negative effects of assistance needs to be rendered explicit to ensure that a net benefit flows from Western efforts.

III. PROBLEMS INHERENT IN WESTERN ECONOMIC ASSISTANCE

The unique character, as well as the sheer range (and scale), of tasks being tackled makes Western aid to Eastern Europe problematic. Drawing on previous models of economic assistance to provide governing principles for today's effort without consciously incorporating the modifications necessary to adapt them to the particular circumstances of Eastern Europe may lead to the squandering of aid. Such aid may also, despite all good intentions to the contrary, result in a deterioration of the economic situation of the recipients.

These assertions are based on the need for as quick an implementation schedule as possible to maximize the likelihood of successful transformation of the existing economic systems. Current discussions of economic policy in the region center not on whether transformation is required, but whether it should be rapid or moderate. Domestic politics will always require the time course for such a thorough transformation to be drawn out.

A lengthy transition works to the detriment of reform. The operational essence of the reform process is to arrive at some point at which the momentum of transformation begins to overbalance the inertia of the past system.¹ The period of transition must be reduced to as short a time as possible.

Drawing out reform may (but need not necessarily) reduce the short-term pain, often because the actual elements become attenuated. At the same time, a longer transition runs the risk that the cumulative inconvenience and suffering sustained by the population will, in the end, be as great as or even greater than it was before the reform, with no ultimate payoff. A quick transition implies greater dislocation to the economy in the politically relevant near term, and it will appear to threaten rents originating from within the prevailing structure of informal property rights. Such rents represent stakes that the population has in the current system even if only in the form of accommodations they have become comfortable with over time.

Several factors reduce the efficiency of more measured reform. To succeed, a program for the radical transformation of a Soviet-type economy must be able to draw on a series of wasting assets. Foremost among such assets is the initial store of optimism, hopefulness, and goodwill of the civil population. This asset buys the time needed for the reform to work. Without it, the time available to reformers becomes ever shorter, while the ability and willingness of the population to accept change from the current regime without substantial political reform decreases. In this analysis, the worst thing one can do is to waste time,

¹The temporal or even operational location of such a point is almost impossible to determine *a priori*.

frittering away such assets with simplistic, ill-thought-out policies, labeled fundamental reform, which do little more than probe at underlying problems and gradually enhance the view that something more major is required.

A second asset is the belief that the responsible authorities are seriously committed to the course that they have charted. This particularly affects the process of transforming economic institutions and existing systems of relations, especially between enterprises and central authorities. If this proceeds slowly or indecisively, internal pressure will arise for the system as a whole to return to the "wild type" it was cultured from.

People and organizations will watch to gauge the degree of serious commitment by reformist regimes before modifying their own behavior; they may as easily become genuinely confused by successive rounds of short-lived "reform" designs. Individuals will then tend to react to uncertainty and apparent crises by drawing upon their experience and training.

A gradual reform process does not support a psychological or institutional break with the past. Moreover, it would permit the emerging systems to attempt "reform" rather than transformation by erecting administrative and legislative solutions in preference to market-oriented ones.² In the meantime, the population would become skittish, or even panic, the authority of the regime would dwindle, and the very word "reform" would acquire a highly pejorative connotation. While dissatisfaction may build, serious economic transformation may then be achievable only after a process of *political* relegitimization.

The Soviet Union, in the sixth year of Gorbachev's tenure as party leader and entering into the fifth year of acceleration/*perestroika* of its economy, finds itself precisely in this unfavorable position. The central government is currently reaping domestic political penalties incurred after gathering the fullest possible measure of ill will by announcing successive "reforms" and then backing away from the announced schedule for implementation once the deleterious effects become obvious to all.

Western assistance to Eastern Europe will do little more than assuage the consciences of the donor governments if it is provided in a form permitting current disequilibrium to persist and East European governments to postpone transformation. The removal of disequilibrium and its systemic progenitors, not its preservation, will require the more active act of will. The latter would occur by default.

Even if a new government sets out on a reform course, the institutional drag will serve to frustrate its design. The tendency toward "levelling" in industry by formal or informal

²This should not be understood as stating an extremist faith in the ability of the market to solve *all* problems.

policies of taxation and subsidization resulting in resource transfers from apparent profit generators to losers has a bureaucratic persistence that is difficult to eradicate, especially in a period of concurrent political transformation.³ The government will most often try to cushion the blow through operation of this paternalistic system no matter how attenuated it becomes.

Western assistance must be structured so as not to perpetuate, however unintentionally, the government's strong behavioral predisposition. The continuing importance of the central budget in all aspects of economic life, combined with the relative underdevelopment of market-type institutions, means that any infusion of resources into the system will, without appropriate cautions, prove highly fungible.

Before the economy is truly transformed, no one can ensure that Western resources intended for improving some aspect of infrastructure or for investment in some branch of the economy would not ultimately have the effect of buying more time for sectors contributing nothing, or less than nothing, to national income. Western assistance could, however, contribute usefully to lengthening the time available to a committed, well-articulated reform process by providing the means to help the transformation over the initial period of implementation.

The trick, then, will be to find the means of buying time without providing additional time to the noncontributing sectors. To reduce the possibility of unintentional negative consequences resulting from Western assistance, such economic aid should be designed to accord with certain underlying principles. Above all else such efforts must be both *prudent* and *contingent*.

Prudence, in this instance, requires recognition that while money *per se* can alleviate certain of Eastern Europe's debts, it will not necessarily help and in certain instances could even hurt the overall process of transformation to more functional economic systems. To the extent that it provides the equivalent of balance-of-payment finance that may be used to avoid the harder measures of reform, such assistance is a detriment. Precisely because of the underdevelopment or nonexistence of major market-type economic institutions, this possibility becomes a major concern. Large-scale assistance should be targeted to meet specific purposes so as to further the ultimate goal of successful transformation to an economic system making more efficient use of domestic resources.

³Until the mechanism for price formation allows prices to capture real resource costs, as long as other administrative restrictions apply, and while accounting practices are not reexamined, it will not be fully clear which enterprises are truly capable of independent, profitable operations.

Contingency suggests that aid of any significant size needs to be predicated on a demonstrated commitment to fundamental reform in each potential recipient country. This restriction is contentious. In many ears, it sounds peremptory, as if the West were putting itself in position to force its system on the former socialist states of Eastern Europe. It sounds ungenerous and so runs counter to the initial proclivities of many in the developed West. Yet, the stricture is based on the recognition that the economic systems operating in the past, and to a large extent continuing into the present, have the capacity for absorbing large quantities of assistance without any lasting effect other than to increase levels of indebtedness. A commitment to reform is needed to ensure that primary attention is given to the flow dimension of the economic crisis and not the ensuing stocks of debt.

This is not to suggest that assistance should be made contingent upon demonstration of successful economic transformation. Assistance is required earlier as an important contribution to achieving success. Rather, the contingency should be upon the establishment of and primary reliance on a new set of institutions and legal relations. The point is not for Eastern Europeans to demonstrate their worthiness of assistance from the West. Rather, it is to make certain that means are in place for treating the causes of malaise, not just symptoms.

Not coincidentally, the successful application of assistance also requires that means be available to treat the causes of the malaise. The actual events ensuing from a transformation process are difficult to predict *a priori*; they are certain to surprise. There needs to exist a mechanism, if only a rudimentary one, that will respond to the midcourse corrections and patches almost certain to be required by a program to modify as complex a system as a nation's economy.

IV. DE FACTO COORDINATION THROUGH DIVISION OF EFFORT

The requirements of prudence and contingency imply a need for coordination among donors. This is a daunting prospect. The potential donors are numerous, the requirements of each potential recipient are not well specified but are instead open to argument and differing perceptions, and the time available seems short. Any coordination attempts appear almost certain to fail because of the limited time and information available and differences in the agendas of the various players.

The barriers to coordination do not stem solely from Western shortcomings. Some are attributable to the Eastern Europeans, as well as to the suddenness of change and confusion on the part of the new governments.

In Hungary, the country perhaps farthest along the road to developing Western-style political and governmental institutions, new leaders are running a new governmental system, and two of the ministries most relevant to economic transformation are new.¹ Considerable infighting, uncertainty over turf, and an inability or unwillingness to come together over assistance issues beset the government, which is therefore not in a position to put out strong signals to Western partners.

In addition to the bureaucratic infighting, the Hungarian government is hampered by current and prospective programs that are too general. This problem arises in part because those with technical expertise within the government hesitate to make recommendations or take strong stands. For example, the simple decision on whether clear air or clean water should have priority in environmental clean-up efforts is largely political, as well as technical. Great uncertainty persists with regard to political direction and the personnel needs of greatly restructured government entities. Experts are waiting for vastly overburdened, newly formed governments to give the signals for the new schedule of priorities.

Eastern Europeans often single out the "Poland, Hungary; Assistance for Economic Restructuring" (PHARE) program of the European Community (EC) as the most coordinated assistance effort. They do so partly because it has a well-defined structure for determining areas for assistance and thus helps to focus thinking and bureaucratic agendas. Its projects are categorized under the five headings of restructuring, trade, environment, agriculture, and education. Better definition permits better targeting.

¹The Ministries of International Economic Relations and of Industry and Trade are amalgamations of functions derived from earlier incarnations.

The speed with which events are occurring seems to exacerbate the problem of coordination among donors. While a coordinated approach would seem desirable, to delay assistance while awaiting appropriate coordination will be to lose the opportunities of the moment and to fail to meet the pressing needs of Eastern Europe.

The answer to the coordination conundrum would seem to lie in somehow obviating the need for specific assignment of actual tasks to potential donors, a design almost certain to be unattainable, unenforceable, and doomed by its inherent rigidity. Rather, coordination might follow naturally if the general functions of the Western players were made clear and agreement on roles reached. Further, if potential projects are themselves categorized by type, falling into two groups primarily, but not exclusively, distinguished by the magnitude of the resources involved, the situation seems less hopeless. Indeed, the division, although the line of demarcation is difficult to pinpoint, seems to be a natural one based on the variety of needs of the region.

SOURCES OF ASSISTANCE

Potential resource contributors include (1) international institutions, e.g., the International Monetary Fund (IMF), the World Bank (WB), and the new European Bank for Reconstruction and Development (EBRD); (2) Western governments, either singly or in concert; (3) private business through direct investment; and (4) philanthropic interests in the West. Each has a role to play.

The international institutions, principally the IMF, are best suited to coordinate assistance to achieve the macroeconomic stabilization required in each reforming country. Substantial financial assistance from these or other sources must be predicated, first, on an agreed-on, sound program of macroeconomic stabilization to be pursued in tandem with any aid program. Any assistance should follow a pattern of well-defined tranches, or stages, with the release of the assistance predicated on maintaining the course of fiscal and monetary stabilization.

The IMF is best suited to play this role, not because of any special expertise with Soviet-type economies, but because of its well-understood and limited charter and its lack of a larger political agenda. Political agendas preclude Western governments from playing a positive role in the stabilization process. They cannot press other governments as effectively as the IMF can to stay an austerity course. The long-term interest of all requires that Western governments not participate in the initial implementation of stabilization measures.

Private Western capital does, however, have an unprecedented and crucial role to play in the provision of assistance. It has the potential to provide substantial financial inputs, to

aid in the privatization of industry, and to offer considerable technical assistance. Direct foreign investment, by its nature, would go to improving the performance of specific sectors and could prove an important means for transferring technologies (both embodied and disembodied), fostering managerial expertise along with its prerequisite managerial infrastructure, and helping to indicate where existing productive assets could be put to best use to enable participation in the world marketplace.

Direct foreign investment will be opportunistic: That is its nature and its strength. Any infusion from this source will be carefully targeted. It will prove most effective and make the largest contribution in countries where Western business interests have most reason to believe that the transformation process will succeed. That is, the more reason potential investors have to believe that the transition to a functioning market economy will succeed, the more they will tend to think of activities as long-term investments rather than as attempts to gain short-term advantages from the existing economic disequilibrium. Longer-term investments reduce the "carpetbagging" problem—the potential to produce a net decrement to the receiving nation's resources. Contingent stabilization assistance provided by the international economic institutions should also be tied to a credible program of reform. Therefore, though not coordinated in a formal way with the stabilization process, direct foreign investment by Western business, by following its own best interests, will be tied to the success of enacting and pursuing well-crafted reform packages.

The balance of this note will discuss a strategy governing the assistance efforts of Western governments.² Aid from this source could be channeled through the international agencies, in which case the prescription sketched above will hold, or it could be administered directly by agencies of the donor government.

Aid administered by agencies of the donor government is in many respects the most problematic. While the interests of international institutions and private investors are easily defined and rather straightforward, the behavior of Western governments may be influenced more by domestic and foreign political interests and pressures than by purely economic considerations. This propensity, coupled with the magnitude of the resources they wield, makes them most susceptible to implementing assistance strategies with potentially deleterious consequences for the recipients.³ Western governments may avoid many of these

²The discussion subsumes assistance provided by foundations. The prescription for the first of the two types of Western governmental assistance discussed below would apply as well to the types of programs foundations might offer.

³The new EBRD, intended to become operational in early 1991, is a potentially large but currently unknown factor. It has the character of both an international agency and a main funding source from its member governments in the developed West to Eastern Europe. Established with an initial capital authorization of 10 billion ecu (about \$12 billion), it has at least the potential of making large capital infusions at an early date. It

pitfalls if they consent to be bound by an additional set of rules, as follows, in their assistance efforts.

INITIAL AND LONG-TERM ASSISTANCE

Western governments should view potential initiatives as falling into one of two classes: those to be pursued initially and at the earliest opportunity and those to be implemented later, during the course of the reform process in each country.⁴ The two types will also be distinguished by the nature of the ends they are designed to achieve. The first class, the projects and programs set in motion immediately, should be directed toward improving human capital endowments and rebuilding and reformulating the institutional infrastructure of East European economies. They may be relatively small scale: any given initiative will have minimal budgetary impact on either donor or recipient. Their effect will come through the leverage of influence rather than from the money at stake. Finally, their hallmark is speed.

Many of these initiatives may begin even before the stabilization and main package of reform measures are formally enacted. The initiatives will help to develop domestic constituencies for, and consensus on the direction of, reforms. They will also build the institutional and cadre infrastructure needed to carry out the reforms. *These initiatives* would suit Western interests and benefit Eastern Europe if donor groups would extensively engage in them wherever the local governments permit them.

Because of the minimal effect of any given effort, the need for coordination decreases. Indeed, such endeavors might even be aided by a multiplicity of responses from different donors in addressing this category of small-scale needs. The problem imposed by the press of events is solved: each donor could and should do as much as can be done in this vein at the earliest opportunity to meet perceived needs. Specific initiatives will be illustrated in the following section.

needs to do so judiciously, with sufficient attention to its responsibilities to assure the fundamental transformation of the economic systems in the recipient states while ignoring political pressures from any side, lest it inadvertently add to the burdens of transition. This should not be a problem if it remains true to the spirit of its charter. According to the EBRD's articles of incorporation, 60 percent of its aggregate lending per year, and 60 percent of the lending to any recipient country over five years, must be committed to aiding privatization and to building the private sector.

⁴A third class, designed to create a climate for easier economic and other interaction between East and West, do not require active fund appropriation. They range from granting most favored nation status, signing tax and investment treaties, and granting access to the various programs maintained by Western governments, to such things as easing visa requirements for Eastern European nationals. This last is by no means the least important step Western governments could take. Though largely economic in character, the trigger for these initiatives should be a perception that democratic processes have gained the ascendancy in any given country. Thus, they fall chronologically and operationally between the two types of effort discussed above: the initiatives of the first type pursued wherever they are permitted and those of the second requiring a demonstrated dedication to fundamental economic transformation.

The second group, large-scale programs, often are directed toward improving the physical infrastructure of Eastern Europe. They may also include macroeconomic stabilization packages to help clear several of the region's debts.⁵ These large-scale efforts will likely dispose of significant resources. Environmental cleanup, transportation and communication needs, and revamping of health care systems are but a few examples. Yet, significant efforts in these areas should be implemented in a rigorous manner, consistent with the principle of contingency in that they should be intimately bound with achieving specific indicators of success in the reform process.

Large-scale lending has several inherent problems. So much is at stake that no one can afford, politically or economically, for individual efforts to go wrong. Such high stakes lead to delay in implementation and an excess of administration. By late June 1990, Eastern Europeans felt that they had seen little or no money from the G-24 group of Western donor governments. They had seen three or four fact-finding delegations a week. These delegations overburdened politicians and the East European bureaucracies, as well as enterprise personnel. New governmental systems have difficulty coping with these visitors, and Eastern Europeans become doubly annoyed because they perceive such expensive missions to come at the expense of the funding for actual programs.

Large assistance ventures present other dangers. If mounted too soon, they may be misdirected to the wrong "needs." For example, agricultural commodity-assistance programs to redress what are perceived as chronic shortages of basic foods have been inappropriate in Poland. The "shortage" existed because of chronic excess demand stemming from unrealistic pricing or because of shortcomings in the distribution system. Commodity assistance would address neither of these problems and could even delay their recognition and solution, while destroying the incentives of newly privatized domestic agriculture in the process.

In general, assistance ventures entailing large resource transfers run the risk of tempting the recipients to delay the fundamental transformation of the economy. This would be most true of assistance to aid in macroeconomic stabilization. Ideally, large assistance programs would incorporate ideas of conditionality. Whereas the hallmark of small-scale initiatives was speed, here the defining hallmark should be contingency.

Large-scale efforts could, and should, come later in the time course of economic transformation. They should be structured in successive tranches, triggered by meeting

⁵However, some institution-building initiatives, such as the creation and initial support of central banks, would also be large-scale ones. They would logically come under this rubric, among the tasks undertaken in the course of transformation. Similarly, some infrastructural programs providing external benefits to neighboring countries, such as pollution abatement and transportation improvements, should be considered early on, albeit with appropriate caution.

certain targets. The conditions need not be tied solely to the sectors in which the assistance system is to lend aid. As an example, successive tranches of a large program to assist rebuilding rural telephone service or electrification might be tied to milestones of privatization and breaking up of concentrated industries.

The linkage of, say, electrification and privatization at first appears beside the point and the two themes unrelated. Yet, such conditionality gets to the heart of the problem of large-scale Western assistance: how to positively affect the transformation of these economies without allowing underdeveloped systems of fiscal control to be overcome by pressures to engage in resource transfers that will shore up existing structures rather than accommodate the process of fundamental systemic change. Major shifts of resources should take only this form.

This linkage might be easier to control and bring into being than might first appear to be the case. Few potential sovereign donors will be in a position to fund such projects by themselves.⁶ They will have to coordinate and consult as a matter of course. The emphasis on contingency will ensure some level of interaction with the international agencies. And while the need is pressing, the time necessary to plan and coordinate such efforts will be afforded by the existence of the first type of Western governmental assistance reducing pressure on Western governments to be seen to be doing "something" to aid Eastern Europe.

⁶Again, the real possibility of generating private commercial solutions to local infrastructural deficiencies should not be minimized. In several respects, this would be preferable to sovereign assistance because the continuing presence of a Western partner as part operator of the resulting systems would reduce many of the risks inherent in Western governmental assistance.

V. SUGGESTIONS FOR ACTION

This section considers more specifically possible U.S. and other Western initiatives of the first type, namely, those introduced at the earliest stage of transformation. These measures will constitute the initial steps of a comprehensive assistance package.

Immediate Western assistance should target the core concern in preparing the way for successful economic and political transformation: persuading the people of Eastern Europe that democracy will serve their long-run interests even more effectively than will the most enlightened dictatorship. The best support for an emerging democratic system is a productive, wealth-generating local economy.

The small-ticket assistance constituting the bulk of early Western efforts should concentrate on education in its various forms. As an example, the Peace Corps program to teach English, initially the target of ridicule in the West, is a model for this type of action. It has been well received in Eastern Europe, where it is seen as a key to opening many other doors.

Even the programs of the first type, though freer and more flexible than the more costly second type of initiatives, will need to follow certain rules to be effective.

- First, initial assistance programs should avoid, wherever possible, the creation of new bureaucratic structures.

Clearly, establishing new institutions will often mean new bureaucracy as a matter of course. But new structures for the administration and disbursement of assistance are to be avoided. Expediency should rule. Programs should work through systems already existing on both the recipient and the donor sides. New structures cost time and money and erect barriers of intermediation, thereby preventing the true needs of ultimate recipients from being heard and addressed.

- Second, the theme of all such programs should be to train the trainers.

To the extent possible, programs should target institutions of education, instruction, and training. Training is the best way to leverage whatever aid is forthcoming, as well as to consummate as quickly as possible a transformation of the basic system.

- Third, programs should project a strong institutional disposition to long-term relationships rather than short-term consultancies.

Short-term relationships (which Groucho Marx might have characterized as "Hello, I must be going") are more likely to waste money, less likely to have lasting effects or contribute to synergy, and most important, more likely to bring in personnel with an interest, predisposition, or lack of practical alternatives other than to perpetuate their own off-the-shelf programs. Longer-term initiatives are more likely to be molded to serve actual needs based on analyses of the local situation. If the program is not structured from the beginning to encourage longer-term initiatives, the exigencies of the moment and the desire of agencies to be seen to be doing *something* in the short term will make the more superficial forms of engagement more likely to be funded.

How are the needs of the region to be identified? Naturally, there must be extensive contact with governments at all levels and with informal or nongovernmental groups. Another way to determine needs is to set up an information service to poll businesses eager to enter the markets of the region. Legislation should enable U.S. Government agencies or the joint U.S.-East European enterprise funds established by the U.S. Support for East European Democracy (SEED) Act to serve as clearinghouses collecting information on what potential investors want to build in the region and what the personnel and skill barriers are to putting these plans into motion.¹ If local conditions appear to favor some service or production arrangement that is impracticable because of the underdeveloped state of training or of institutional support in some area, programs could be developed combining government and private resources to provide the training. This makes for further coordination between governments and the actions of private business.

Those shaping such programs will have to decide whether it is more efficient to train East Europeans at home or abroad. On the one hand, training in the donor country would cost more and thus limit the number of trainees. It might even be counterproductive in training areas where information could be imparted more easily on-site, or where unmodified international practice would not suffice to meet needs and would have to be shaped to local interests, practices, and concerns (e.g., training for local law enforcement personnel). Further, some thought would need to be given to how to guarantee the return of the trainees to their countries of origin. Perhaps most seriously, such an approach would demand selection mechanisms not required by on-site programs. These competitions then become almost irresistible objects for politicking, patronage, and local power plays.

On the other hand, training in the donor country has one tremendous advantage over training in the recipient country. Eastern Europe suffers from highly structured approaches

¹The Department of Commerce's East European Business Information Center might be a natural conduit.

to every aspect of daily life, which are so pervasive and so common as to be virtually invisible to those most affected. The dead hand of what Eastern Europeans "know" to be true, to be the accepted way to do things, is in some ways the greatest handicap the region bears. A Western expert going to Eastern Europe will impart what he knows, but the East European trainee will often place the knowledge in his or her own familiar frame of reference. This effect could undercut the purpose of the exercise and cause undetected miscommunication.

In some training areas, it would be valuable to impart an entirely new frame of reference, or at least to indicate that there may be other ways of achieving a given end than the tradition with which the trainee is familiar. Such insights are not readily transferable in an overt process; rather, they need to be perceived as a systematic totality by the trainee. Scholarship programs in the donor country might provide this type of information transfer. While an overall program might have only a few such trainees, each trainee would have the potential to vitalize the existing system when he returned home. A few such trainees could greatly magnify the potential effect of programs in the recipient country. After returning home, they would prove effective in guiding the efforts of their home-trained compatriots to implement new approaches.

The remainder of this section suggests specific programs and program elements that would meet the most pressing needs of the recipients. The intention is to illustrate the wide range of projects of this type, as well as to explicitly identify some of Eastern Europe's most pressing needs.

LOCAL GOVERNMENT

A phenomenon common to the region, indeed, the essence of the political transformation of 1989, is the decentralization of political authority. As part of the process, local governments in Eastern Europe are gaining control of and responsibility for the maintenance and provision of local services. No longer will they be sustained by formal subsidies from the center or informal subsidies shunted through the alternative mechanism of the local party structure.

Small governments must now guarantee local finances, solve local problems, deal with environmental and public health issues on the local level, and engage in a wide range of public works projects. They completely lack expertise and tools, both analytical and administrative, to deal with these issues.

The breakdown of local government structures in the wake of systemic changes and the removal of the former integument of the local party networks would adversely affect popular perceptions of the democratization process. Breakdowns would also compromise the

ability to absorb and sustain economic transformation. In particular, they would complicate efforts to ensure that Western direct investment does not accrue exclusively to the capital cities.

Local governments present themselves as a potentially fruitful conduit for assistance. Sister Cities International, an already existing institution, might serve as a bridge between donors and local governments. U.S. Government funds could be used to establish programs to send experts to work with local governments, set up general systems approaches to a standard package of problems, and invite local government officials to observe local government operations in the United States or Western Europe.

PROFESSIONAL EXCHANGE

In line with the general recommendation to train the trainers, professional exchanges could play a big role. Particularly crucial to support both emerging democracy and economic transformation would be to provide experts in such areas as banking, journalism, accounting, and law. The existing Fulbright and International Research and Exchanges Board (IREX) programs could quite adequately serve this end.

In some instances, these professional exchanges would introduce educational assets that had never before existed. For example, universities throughout the region are reassessing their need for large departments of scientific socialism while virtually no means exist for instruction in political science in the Western sense. Intellectual assistance would aid the process of conversion.

Professional exchanges need not necessarily be confined exclusively to the university setting. The Fulbright auspices could be used also for professional seminars and training programs.

BANKING

Successful economic transformation requires independent and viable central and commercial banks. A degree of expertise already exists in some countries, while in others such institutions operate only at rudimentary levels. Instruction and advice in the basic tenets of banking practice will provide economic systems with experts in such vitally needed functions as credit evaluation, risk analysis, monetary policy, and the art of maximizing financial resources consistent with sound banking practices.

PRESS

New journals, newspapers, and other media sources are springing up daily throughout the region. Enthusiasm and interest are high, while the level of professionalism and

journalistic responsibility is often distressingly low. The training of journalists and publishers in the ethical and financial aspects of journalism would contribute greatly to ensuring the existence and influence of a viable free press.

LEGAL SERVICES

Although many unsatisfactory laws have been taken off the books in postrevolutionary Eastern Europe, a problem remains because so few new ones have replaced them. Thus, no laws governing libel or conferring other forms of press control have replaced the shattered former system of censorship. Magazines offering pornography of the most graphic and brutal nature are sold out of the same kiosks where children buy their comic books. The restrictive and repressive laws on small business have been chucked, but they have not been replaced with a new code of business law, covering such areas as reporting and auditing requirements, contracting, and bankruptcy.

Western legal experts are needed to assist in the massive task of framing new legislation. Beyond purely technical advice, expertise will be needed to gain some insight into what the consequences of specific legislation might be, given the realities of each country's situation.

SMALL BUSINESS

Experts from Western small-business administrations could help to establish chambers of commerce and other counterpart institutions in Eastern Europe. Even where these already exist, they are either discredited or in need of serious revision. Privatization pressure would be strengthened by establishing lobbying groups of small-business owners.

EQUITY MARKETS

An exchange program could be developed in concert with the stock exchanges—the NYSE, AMEX, NASDAQ—and the Chicago Board of Trade to send over employees who can aid in the reestablishment of local exchanges in Eastern Europe by working in them for a time. A functioning exchange will be a crucial tool in aiding the privatization of state industry on a local basis. Well-established bourses will ease some political worries tending to slow privatization by assuring as far as is possible that shares in former state enterprise will continue to be traded on domestic exchanges and not on those of the West. East Europeans could also participate in the training programs of Western investment banks.

PARLIAMENTARY SUPPORT

A characteristic of the political transformation of the region has been the transfer of power from the party to parliaments. Whereas almost without exception the former communist parliaments met for a maximum of only a few weeks of the year to rubber stamp government decrees, they now have primary responsibility for legislation and governance. Parliamentarians in Eastern Europe as yet have no professional staffs to assist them with research, drafting of legislation, or constituent outreach.

Exchange programs with U.S. congressional staffers, or perhaps even better, with the staffs of various state legislatures, would considerably strengthen staff work in East European parliaments by providing models, as well as practical advice. Such exchanges are the single most useful assistance the U.S. Government could render in consolidating the democracies of the region by assuring parliamentary control. Once such programs were in place and both sides had a better sense of needs and likely scale of effort, follow-on programs for assistance could focus on providing such tools as computers, related equipment, data bases, and other aspects of infrastructure.

ENVIRONMENT

Environmental degradation has been disastrous throughout Eastern Europe. Environmental problems have troubling long-term implications for public health. They also have short-term economic consequences as major source polluters are identified and shut down under public pressure: Shutdowns often engender serious supply problems for economies characterized by high levels of concentration in most industrial sectors. Libraries, data bases, and contact with Western environmental control experts are greatly needed.

EDUCATIONAL MATERIALS

Books, books, subscriptions to Western journals, and more books are needed throughout the region and in all sectors and in all fields. Published materials are scarce and terribly expensive to countries trying desperately to achieve some measure of fiscal control by reducing subsidies. Books are needed, wanted, and will be heavily used, thus highly influential. In this connection, some thought might be given to the fate of the libraries attached to the U.S. forces in Western Europe, soon likely to be drawn down to some as yet unspecified degree.

STUDENT SUPPORT

Scholarships need to be provided to enable East European students to attend U.S. universities. Many schools are prepared to grant tuition waivers but are not capable of covering housing or transportation costs. U.S. funds could be used to make up the shortfall.

ACCOUNTING AND ENTERPRISE ORGANIZATION

Much has been made of the need to teach management skills to enterprise personnel. Eastern Europeans find themselves overburdened with offers to establish management training centers. Much of this attention, based on misassessment of the problems ailing East European managers, has been misplaced. It is not the skill of the managers, but rather the environment in which they manage, that wants change. There is room for massive Western assistance.

As with many laws identified with the past regime, the official accounting practices of the past are now no longer mandatory. As with other laws, however, nothing has replaced old accounting practices. Therefore, practice reverts to the methods most familiar to enterprise personnel. For lack of an alternative, the accounting methods of the past, and former systems of enterprise management and organization, continue. Designed to shape the enterprise as an instrument within a system of hierarchical command, these systems fail to provide the information needed by independent, competitive firms intended to play a part in a transformed economic system.

Considerable assistance is required in framing and diffusing awareness of accounting practices and enterprise organizations appropriate for the new requirements of enterprises. Such changes will by no means guarantee appropriate incentives; these will require other changes in the economic sphere. But accounting and organization changes will render enterprises more responsive to the opportunities presented through modification of the economic system. Such changes are crucial to the economic well-being of the region as a whole.

RETRAINING

The potential for retraining intellectual workers deserves thought. Perhaps the biggest barrier to political and economic reform is the requirement for agents to behave in ways both new and unfamiliar, if not unnatural. Under stress, one is inclined, if choice exists, to rely on past training for solutions. Similarly, the tendency of the system as a whole when stressed is to revert to earlier patterns.

The profound changes in Eastern Europe will make many potentially useful members of society redundant. These people—military political officers, officials of planning agencies

and price offices, etc.—potentially form a class of disaffected formerly important persons who have little obvious place in the new circumstances. Even perceptive critics of the former economic system, the providers of the intellectual antecedents to the revolutions of 1989, may also find themselves at a loss when the objects of their years of study and mobilization efforts no longer exist. They are too valuable a resource to be lost.

Provision should be made for some form of counseling in ways of finding their place in the new system that they helped to bring into being. The degree to which they can conform to evolving circumstances will in itself be a measure of how much systemic evolution occurs. Strategies to identify and reshape skills already possessed will help ease entry into new circumstances.

SCIENTIFIC EXCHANGES

All East European countries possess large scientific R&D establishments. In some fields, several are distinguished by the quality of their personnel. By and large, however, such establishments have contributed a disproportionately small amount to the international pool of knowledge and invention. Again, a good deal of the blame can be laid to the bureaucratic system within which they operated, both domestically and multilaterally with Soviet bloc colleagues.

Today, a worldwide current of international cooperation runs through many areas of science and technology. The major avenue for such cooperation in the East—the Council of Mutual Economic Assistance (CMEA) and, in particular, its large-scale Comprehensive Program for Science and Technology to the Year 2000—seems likely to end. Further, the existing systems of Eastern Europe do not include many aspects of R&D administration and national science policy formulation taken for granted in the West (e.g., merit panels, decentralization of effort, and peer review). East European scientific establishments must be drawn into the current of international discourse.

The shortcomings noted above suggest that more resources and emphasis should go to exchanges in both directions. The benefit that Eastern Europeans would reap from coming to the West seems obvious. The *quid pro quo* that the East European visitors would provide is less obvious. Some sources suggest that these personnel, as a result of being forced to work with antiquated equipment and relatively fewer resources, are often better at experimental design than their Western counterparts. In this area, the commerce in benefits stemming from Western assistance may well flow two ways. Visa requirements should be eased and fellowships provided for East European scientific workers, while the resources to maintain Westerners working with their colleagues in the East should be increased.

VI. CONCLUSION

The need for substantial financial assistance continues. Each nation of Eastern Europe labors to a greater or lesser degree under several forms of debt. The earliest assistance from Western governments should be channeled through international organizations best suited to impel the fledgling governments of Eastern Europe to stay the reform course while implementing feasible policies of macroeconomic stabilization. After the structure for transformation has been firmly established, Western governments may consider more massive infusions of material assistance to potential recipients, although private commercial efforts could also contribute much.

Aid must, however, always maintain the primary objective firmly in view. It should be tied to ensuring the successful transition to economic systems better suited than those of the past to utilizing domestic resources. To do otherwise, in spite of all good intentions to the contrary, would be to prolong the existence of current systems by providing means of avoiding the painful necessity for change.

Enacted in some haste by a U.S. Congress eager to assist the great changes in Eastern Europe, the SEED Act has served and should continue to serve as a model for immediate action by the governments of the West. The press of events caused the act to take the form it did, but it is an appropriate and vital part of a coordinated approach.

Western governments should stimulate private initiatives, facilitate contacts between their citizens and those of Eastern Europe, provide expertise on the construction and rehabilitation of institutions, and help to build the skill types needed for the successful transition to market systems. Now that time is more of a luxury than it was in autumn 1989, the U.S. Congress should not enact initiatives that may prove too challenging to the institutions of East European countries still struggling with problems of stabilization. The legislative successors to SEED should carry forward purposefully and by design what was put in place by good intentions and default in the original.