Promoting Democracy and Free Markets in Eastern Europe

Charles Wolf, Jr., editor
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Charles Wolf, Jr., editor

Prepared for the Agency for International Development

RAND
PREFACE

On September 21-22, 1990, RAND convened, in collaboration with the Sequoia Institute and with funding provided by the Agency for International Development, a conference of selected participants from government, universities, and the business and financial communities to consider whether and how specific types of actions, policies, and programs can advance the objectives set forth in the Support for East European Democracy (SEED) Act (P.L. 101-179)—namely, to "contribute to the development of democratic institutions and political pluralism" and "promote the development of a free market economic system"—through use of the funds and instruments provided by the SEED legislation.

This report contains the papers and discussant comments presented at the conference, based on information available at that time. It should be of interest to those in government and the private sector who are concerned with problems, programs, and prospects of democratic and economic reform in Eastern Europe and other areas.
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CONFERENCE PARTICIPANTS

Supporting East European Democracy
and Free Markets
September 21–22, 1990

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Michael Dardia
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1. INTRODUCTION: TRANSFORMING COMMAND SYSTEMS

Charles Wolf, Jr.

The fall of the Berlin Wall in November 1989 was one of the "defining moments" of global history in the post-World War II period. It confirmed the collapse of communism in Poland and heralded communism's impending fall in East Germany, Czechoslovakia, and Hungary. It presaged the emergence of democratic leaders and elections in Central and Eastern Europe. The fall of the Berlin Wall also reflected the consequences of Mikhail Gorbachev's perestroika, glasnost, and "new thinking." And it probably accelerated the process that formally ended the Communist Party's legal monopoly of political power in the Soviet Union through an amendment to the Soviet constitution, which presaged even more fundamental changes in the future.

The remarkable momentum of these pluralizing and democratizing changes brought with them in 1990 the unification of Germany and the reigniting of age-old national and ethnic passions and rivalries within the Soviet Union, the Baltic states, and the twelve other Soviet republics, as well as in Czechoslovakia, Yugoslavia, Romania, Hungary, and Poland. Some of these currents of change recall the deep-seated antagonisms and conflicts of the past that portend not "the end of history," as Frank Fukuyama has suggested, but rather its "reemergence."

These political changes have been accompanied by a massive, almost unanimous, outpouring of rhetoric extolling the benefits of free market systems and contrasting them with the stultifying rigidity of centrally planned command economies. Recognition of the failures of command economies and the need to transform them has been the source of this remarkable shift in rhetoric. But the unanimity and ubiquity with which markets have been advocated—in the Soviet Union, in Eastern Europe, as well as in China and the Third World—obscure the profound divergences over what the terms mean and what they imply for transforming command economies into market-oriented ones. These divergences are latent in such frequently used

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but self-contradictory terms as "market-socialism" (a term invented by the Hungarian economist Janos Kornai, but subsequently rejected by him), "regulated socialist markets" (a term favored periodically by Gorbachev and certain "conservative" Soviet economists), and what some Chinese leaders have described as a system between capitalism and socialism, which they call "socialism with Chinese characteristics."

The underlying disagreements concern the details about transforming command systems into market ones, but in this instance, as in others, the essence is in the details. These details relate to whether markets should be "free" or "regulated," competitive or "social," whether the markets' intended reach should be extensive and predominant or partial and limited, whether transformation should be rapid or gradual, whether the emergent system should be open to international competition allowing free movement of capital and commodities or protected from it, and finally, whether the scope of the government sector, at the end of the process, should be extensive or narrowly circumscribed.

It is not surprising that these divergences are so deep. The rhetoric of markets and marketization has been adopted by a remarkably diverse group of advocates, including communitists, ex-communists, erstwhile central planners, social democrats, "liberals," and "radicals," as well as new and aspiring entrepreneurs in the prospectively transforming command economies. As a result of this diversity of views as well as viewers, the ensuing policy debate has often been muddled and the essentials of the transformation process frequently misunderstood.

At the request of the Agency for International Development, and in collaboration with the Sequoia Institute of Washington, D.C., RAND organized a conference on "Supporting Democracy and Free Markets in Eastern Europe" in Santa Monica, California, on September 21–22, 1990. The purpose of the conference was to consider whether and how specific types of actions, policies, and programs can advance the objectives set forth in the enabling legislation passed by the Congress and signed by the president entitled "Support for East European Democracy (SEED) Act of 1989." The objectives established by this legislation are to "contribute to the development of democratic institutions and political pluralism," and "promote the development of a free market system"—through use of the funds and instruments provided in the SEED Act.

The United States and the West have been in the "aid business" for over four decades—a period that has included aid to Greece and Turkey in the post–World War II period, the Marshall Plan, the European Recovery Program, President Truman’s Point Four pro-
gram of technical assistance, and the ensuing development assistance program to the Third World. The present context in Eastern Europe, and the responsibilities that are set forth in the SEED legislation, are different in several important respects from these precedents. For example, in Marshall Plan assistance to Western Europe, the programs had more or less finite goals of restoring and revitalizing pre-war systems and institutions, and these goals provided a calculable basis for estimating the funds required for their realization.

The series of U.S. and other government programs in the post–World War II period to assist the development of the less-developed countries focused on project and program assistance as well as technical assistance to expand the physical capital and the human capital inputs for rapid growth in these economies. The purposes set forth in the SEED legislation—namely, to promote democracy and free markets—are more ambitious than those ascribed to these earlier programs. Moreover, the funds available for achieving these formidable objectives are modest indeed: for example, on a per-capita basis for the countries of Poland, Czechoslovakia, and Hungary, the total amount of U.S. aid that has been appropriated through 1991 amounts to $14. Of course, larger amounts of funds are forthcoming from the contributions of Western Europe and Japan. However, at least in the case of Germany, the amounts likely to be forthcoming will be considerably constrained by the enormous demands accompanying the unification of East and West Germany.

Not only are the outside funds available for promoting democracy and free markets quite modest, but the most effective means and sequences for advancing these ambitious objectives pose formidable challenges. To some extent, the SEED legislation should perhaps be viewed as providing symbolic support—albeit valuable symbolic support—for the aspirations of the East European peoples and governments for democracy and free markets. Both democracy and free markets are complex and finely articulated systems. They can be rooted in differing cultures and traditions, as suggested by the vitality of Indian democracy (despite the limited role of free markets), as well as by the Japanese and Korean experiences with both free markets and democracy. However, the indigenous “rooting” process depends critically on national leadership and the achievement of national consensus. These ingredients cannot be readily packaged and exported from well-wishers abroad.

Yet external encouragement, support, and counsel can be invaluable in helping to advance democracy. They can help to provide the legal and informational frameworks that will encourage appropriate checks
and balances, protect the rights and expression and participation of minorities and interest groups, facilitate the development of a free and competitive press, and establish the rule of law.

In promoting free market systems, external technical assistance can also be helpful by establishing the necessary ingredients of such systems: namely, monetary and fiscal control and discipline, price and wage deregulation to link prices and wages to costs and productivity, privatization and legal protection of property rights and the breakup of state monopolies, a social safety net to protect those who may become unemployed as transformation proceeds, and a move toward currency convertibility to link the transforming economies to the world economy and to competition in international markets. However, in the final analysis, the “rooting” of democracy and free markets in Eastern Europe, as well as elsewhere—that is, the implementation and adaptation of the relevant theory and technical advice—depends on the people and the leadership of these countries, building on the groundswell of willingness to move in these directions.


The sections in Part I address the relevance or irrelevance of precedents, experience, and the institutional and human “capital” derived from prior U.S. government-to-government assistance programs, including especially the Marshall Plan, NATO, and development assistance to the Third World. In Section 2, Thomas Schelling, noting that the Marshall Plan is sometimes invoked as a possible model for the extension of aid to Eastern Europe currently, clarifies what the Marshall Plan was, how it operated, and notes some lessons learned from it. One major difference between now and then, he observes, is that the United States was the sole source of aid,

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1 These papers contain facts and reflect conditions as of the date of the conference, September 21–22, 1990. The papers have not been updated to reflect subsequent events.

I would like to acknowledge the contribution Michael Dardia and Vladimir Shkolnikov, RAND Graduate School Fellows, made to the conference in their role as rapporteurs. Their draft of the proceedings was drawn upon in the writing of this introduction.
Indeed the sole source of dollar capital inflow. In determining aid allocation, U.S. aid was matched against agreed estimates of each country's "needs" for additional dollar imports. One of the lessons from the Marshall Plan, according to Schelling, is the difficulty of terminating aid, because termination is often construed as the severance of a relationship.

In Section 3, Nicholas Eberstadt submits "Aid for Eastern Europe: A Skeptic's View." Eberstadt observes, ironically, that the sorts of policy advice that AID has usually offered to developing countries over the past two decades would have been more likely to lead the East European countries to the same sorry economic situation they find themselves in now—namely, serious debt problems, state-owned enterprises, structural distortions—than to lead them toward reliance on markets, private enterprise, and self-sustaining growth. Eberstadt expresses doubts that prior successes in U.S. development efforts—namely, the Marshall Plan, Japan, Germany, Korea, and Taiwan—involving elements that are likely to be echoed or replicated in Eastern Europe under current conditions.

The sections in Part II explore whether and how pluralism and democracy can be advanced, as proposed in the SEED legislation, through actions, programs, and policies to be pursued—or avoided—that will encourage appropriate checks and balances in the exercise of government authority, encourage participation by existing and emerging groups and interests in the East European countries, and provide protection of minority rights and values. In Section 4, Graham Allison and Robert Beschel address the question, "Can the United States Promote Democracy?" After reviewing the theoretical literature on the subject, they "find it puzzling that . . . students of democracy are almost unanimous in their skepticism or negativism about the U.S. promotion of democracy." Their own assessment is more optimistic. They offer thirteen "principles for promoting democracy"—some relating to the promotion of an external environment favorable to democracy and others relating to the infrastructure of democracy and to strategies for democratization. For each of these categories and actions, Allison and Beschel propose a set of "dos" and "don'ts."

Consideration of the general issue of advancing pluralism and democracy is followed by sections by James Brown and Alex Alexiev, respectively, which consider how these objectives can be furthered, as well as what may hinder their attainment, in Eastern Europe. In Section 5, "Helping Eastern Europe: Thoughts, Suggestions, and Some Mild Obsessions," Brown writes that "economics are paramount and all-
pervasive" and that the "premature introduction of competitive, pluralist politics in Eastern Europe could jeopardize the entire prospect of civil society." Among the specific suggestions he makes for U.S. actions are the following: educational exchanges at every level, a strengthened role for the U.S. Information Agency, and refurbishing and redesigning Radio Free Europe.

In Section 6, Alex Alexiev focuses on special problems of Bulgaria, Yugoslavia, and Romania—the "Southern Tier." His discussion emphasizes the bleak prospects for democracy in Romania and Bulgaria, where the renamed communist parties retain a predominant influence and incumbency. He further envisages the breakup of Yugoslavia, with Serbia taking an authoritarian path and Slovenia and Croatia likely to move toward democratization.

Part III is concerned with promoting free market systems by undertaking, or avoiding, various actions and programs relating to monetary and fiscal measures, price and wage deregulation, capital market development, legal frameworks to protect property rights, privatization, and dispute resolution. In Section 7, Leif Olsen addresses the question of how to promote free markets in Eastern Europe. Toward this end, he addresses successively the need for appropriate legal frameworks, privatization, price and wage deregulation, the creation of credit markets, the role of foreign capital and joint ventures, and the need for social security and an unemployment insurance system.

Steven Popper's Section 8 on "Assistance to Eastern Europe from Western Governments: The First Steps," urges that these "first steps" should emphasize the stimulation of private initiatives, facilitation of contacts between citizens of the West and Eastern Europe, provision of expertise on the construction and rehabilitation of institutions, and assistance in building the skills necessary for successful transformation to market systems. Popper points out the danger of enacting initiatives that may prove too challenging to the institutions of East European countries still struggling with problems of stabilization.

In Section 9, "Reform in Eastern Europe: What Must Be Done? What Can Outsiders Do?" Lawrence Summers groups his recommendations under three categories: (1) stabilization of the macroeconomy, (2) building the institutions of capitalism, and (3) creating the laws and rules of capitalism. He expresses doubt that the necessary transformation can be made "excessively rapidly." He has reservations about too-rapid privatization and argues that "selling off all the [state] enterprises quickly is just not realistic."
In Part IV, dealing with ongoing U.S. government assistance to Central and Eastern Europe, two U.S. government officials describe and discuss the design and content of U.S. government assistance programs.

In Section 10, "An Overview of U.S. Government Assistance to Central and Eastern Europe," Kenneth Juster summarizes the "new policy standard" to differentiate U.S. assistance to each East European country in terms of its progress toward four objectives: (1) progress toward political pluralism, (2) progress toward market-oriented economic reform, (3) enhanced respect for human rights, and (4) willingness to build a friendly relationship with the United States. One of the priorities of U.S. assistance is the development of democratic institutions and the rule of law, and a second priority is technical training and assistance in support of market-oriented economic reform. Juster describes the content and scale of recent and current efforts in both of these domains.

In Section 11, "AID Programs in Central and Eastern Europe," Carol Adelman describes several lessons from prior U.S. aid experience that the current programs in Eastern Europe are intended to reflect. These lessons include the following: rewarding countries by providing assistance after they have undertaken free and fair elections and implemented sufficient economic reform; undertaking projects on a regional rather than country-specific basis; stipulating that assistance is intended to be temporary or transitional; emphasizing technical assistance and training rather than cash transfers or equipment; and streamlining the administrative apparatus for the aid programs.

FROM COMMAND ECONOMIES TO MARKET ECONOMIES

Implicit in many of the sections as well as in the conference discussion that accompanied them is a "systems approach" to the transformation of centralized, command societies into pluralistic, market-oriented ones. This approach is generically applicable to the transformation process, whether the locale of its application is Eastern Europe, the Soviet Union, China, or any of the centrally controlled economies of the Third World.

To be sure, each locale differs in its historical circumstances, cultural affinities, institutional antecedents, and existing physical, social, and political infrastructures. But the differences, while important, are incidental to an essentially similar task. Transformation depends on implementing simultaneously, or at least contemporaneously, a package of six closely linked and mutually supporting elements:
- Monetary reform to ensure control of the money supply and credit;
- Fiscal control to assure budgetary balance and to limit monetization of a budget deficit if one occurs;
- Price and wage deregulation to link prices and wages to costs and productivity, respectively;
- Privatization, legal protection of property rights, and the breakup of state monopolies to provide for competition as well as worker and management incentives that reflect changes in relative market prices;
- A social "safety net" to protect those who may become unemployed as transformation proceeds; and
- Currency convertibility to link the transforming economy to the world economy and to competition in international markets.

The first two elements (monetary reform and fiscal control) and the fifth (the social safety net) create the broad macroeconomic environment that enables the incentive mechanisms of the other three to move resources toward more efficient and growth-promoting uses. The government's role is both crucial and paradoxical: crucial in initiating all of the elements, yet paradoxical because the process that the government initiates is intended to diminish its ensuing role, displace its overextended functions, and reduce its size in favor of market mechanisms.

Each of the six elements is less likely to be effective without the reciprocal support provided by the other elements. Hence, attempts to reform nonmarket economies by piecemeal steps are more likely to founder than to succeed.

Consider, for example, the link between the first two elements. Monetary reform is necessary to limit growth of the money supply to a rate that accords with the growth of real output. It is also a necessary means of providing access to credit on the basis of borrowers' economic capabilities and their associated risks, rather than on the basis of their political connections or credentials. A competent entrepreneur with a good idea should be able to obtain credit not available to someone whose principal distinction is membership in the governing political party or kinship to a government official.

Fiscal reform requires a budget process that constrains government expenditures to a level approximating that of revenues, and precludes or limits "off-budget" subsidies and other transactions that would disrupt monetary discipline, as well as budgetary balance. Recourse to
extrabudgetary subsidies to bail out deficit-ridden state enterprises has been standard procedure in the Soviet Union, China, and other command economies. Fiscal and monetary reform should preclude its recurrence. Usually, the complementarity between monetary and fiscal reform is facilitated by institutional separation between the finance ministry (or treasury) and the central bank or banking system.

In turn, the third element—deregulation of prices and wages—requires monetary and fiscal restraint if prices and wages are to be linked to real costs and productivity, while avoiding general inflation. Goods that are in short supply or are costly to produce should experience price increases relative to those that are more abundant and less costly. In turn, these price increases provide signals and incentives for increased and more efficient production. Similarly, wages paid for more productive labor and skills should be expected to rise relative to those that are less productive. The newly established parities among costs and prices should operate in the public sector, as well as the private sector.

For deregulation of prices and wages to promote efficient use of resources, the fourth element—privatization, legal protection of property rights, and the breakup of state monopolies into competing entities—must be implemented at the same time. This requires an appropriate legal code and appropriate procedures for resolving disputes over property transactions and acquisitions, as well as litigation associated with prior ownership claims.

The fifth element—establishment of a social security system as a “safety net”—is also essential for the transformation process to succeed. Without it, the process may create fear of widespread unemployment, social stress, and political instability, thereby seriously impeding the transition.

In most command economies, social protection—against illness, disability, age, and unemployment—has principally been the responsibility of state enterprises. As privatization proceeds, these responsibilities are likely to become one of the principal functions of government, financed by taxation and by payments levied on the insured. In the initial stage of transformation, taxation will probably have to bear most of the burden, although the real incremental burden imposed on the economy by the social safety net is likely to be less than is usually assumed.

The final element—currency convertibility—is essential to complete the transformation process by linking internal markets and their prices, wages, productivities, and technologies to those of interna-
tional markets. This linkage provides the opportunity for comparative costs and comparative advantage to operate for the benefit of the transforming national economy. With a convertible currency, the transforming economy can determine those goods and services it can produce at relatively low cost compared to the costs of other countries, and those it produces at relatively high cost. In response to convertibility, exports of the relatively low-cost goods will expand, as will imports of the relatively high-cost ones.

If the other elements of the package—especially monetary and fiscal discipline and market-determined prices—are implemented effectively, currency convertibility with a floating exchange rate can be embarked upon and sustained with minimal hard currency reserves, contrary to a frequent argument about the need for large reserves as a precondition for convertibility.

The interactions and mutually supporting relationships among the six elements of the transformation process are summarized in Fig. 1. The lines indicate the contribution by one element to the effectiveness of another to which the arrowhead points. (For example, monetary and fiscal reform contribute to the effectiveness of price and wage deregulation.)

In sum, the process of transforming command, nonmarket economies to market ones is both better understood and more tractable than one might suppose after listening to much of the public debate. Transformation is a systems process encompassing the interactive and mutually supporting elements described above. Trying to transform a centralized command system to a pluralistic, market one without the synergy provided by all of these elements is like trying to swim with only one arm and one leg.

DEMOCRACY AND FREE MARKETS

Beyond the specification of the essential attributes of democratic systems—division of governmental powers, checks and balances in the exercise of such power, free press and free elections, a genuine rule of law and established procedures for changing the law, and so on—preferred techniques, programs, and sequences for promoting democracy are not well understood, let alone fully tested and proven. Equally unclear is the precise and predictable relationship between democracy and free markets. According to some views (for example, Hayek and Friedman), free markets are an essential precondition for democracy. According to other views (Anders Aslund), democracy is a "necessary condition" for free markets.
A further complication is introduced by considering the relationship between democracy and markets in the long run and in the short run. For example, it is possible that, in the long run, democratic systems will result in free markets because decentralization of economic power will follow decentralization of political authority. It is also possible that free markets may conduce to democracy in the long run by a process in which dispersion of economic power results from market competition, and decentralization of political power follows from dispersion of economic power. Yet it is also possible that those relationships need not hold in the short run.

A variety of experiences in individual countries underscores the complexity of the relationship between democracy and free markets. South Korea, Taiwan, Singapore, and Chile have experienced several decades of free markets, together with highly authoritarian political systems. On the other hand, India has had a functioning democracy for four decades together with a socialist rather than a market sys-
tem. Turkey has had a similar experience until its relatively recent and gradual move toward a more market-oriented economic system.

These complexities arise because the channels for linking economic power and military power are numerous and imperfect, and can be blocked or lubricated. Both democracy and free markets are complex and finely articulated systems. They can be rooted in differing cultures and traditions, and they can also fail to take root in differing cultures and traditions. Whether the indigenous "rooting" process prevails depends critically on national leadership and the achievement of national consensus—ingredients that can be assisted from abroad, but cannot be readily packaged and exported. There is no single formula for assuring democracy and free markets. Their linkage requires a sophisticated blend of the tools, analysis, and paradigms of modern political economy, combined with knowledge and experience in the context of specific countries and regions.

UNRESOLVED QUESTIONS

In the course of the conference discussion, several issues and questions were addressed without reaching consensus. These areas of contention, representing possible topics for further investigation, include the following issues:

• Should the primary aim of aid programs be breadth in the aid effort, or concentration on a few projects and sectors? Arguing for a broad scope is the plain fact that the "needs" are extensive, and there is not a clear body of knowledge that convincingly supports the concentration on particular sectors. Advocates of a narrow focus stress the facts that funds and talents are limited, and the risk of scattering aid in a series of half-measures is substantial.

• Should aid donors be more concerned with developing a "fair" press or a "free" press? Supporters of the premise of a fair press expressed concerns about the appearance of sensationalist, demagogic tabloids, and advocated the development of a balanced and responsible press. On the other hand, advocates of a free press believe that any new entrants into the media enhance competition and the expression of diverse views and, moreover, that government advisement that restricts free expression is more of a danger than a protection.

• Are political reform and economic reform complementary, conflicting, or independent? Does one precede the other? Some of the conference participants expressed the view that premature de-
mocratization could impede serious economic reform by removing the strong central authority needed to rationalize and enforce change. Others argued equally strongly that political reform is essential to accompany economic reform so that the latter will be embedded in a democratic context.

- Should the pace of privatization be fast or slow? Proponents of a measured pace of privatization expressed the fear that the privatized assets would fall into the hands of illicit groups—the nomenklatura and black marketeers, for example—because these are the groups with sufficient wealth to bid for the privatized assets. As a consequence, further reform efforts might be discredited in the eyes of the public, resulting in a slowing or reversal of change. On the other hand, those who advocate a rapid pace of privatization suggested that the sooner ownership rights are transferred from the state, the sooner and more likely is market discipline and significant economic restructuring to take place. Still other participants argued that it is not appropriate to make a uniform choice between fast and slow privatization. For example, housing, services, and small enterprises can be privatized rapidly, while the privatization of large state enterprises might be delayed until appropriate employee ownership plans are developed and a sufficiently broad distribution of assets can be accomplished.

These issues, as well as others addressed in this report, were highlighted at RAND's exploratory 1990 conference on the SEED legislation. To resolve them will require further research and experience as well as continuing discussion and debate. The challenge of promoting democracy and free markets will be high on the global agenda of the 1990s and beyond, not only in Eastern Europe but in the Soviet Union, China, Cuba, Vietnam, North Korea, and in much of the less-developed world as well.
PART I

PRECEDE NTS AND EXPERIENCE FROM PRIOR U.S. GOVERNMENT ASSISTANCE PROGRAMS
2. THE MARSHALL PLAN: A MODEL FOR EASTERN EUROPE?

Thomas C. Schelling

The Marshall Plan is occasionally invoked in discussion of aid for Eastern Europe. Sometimes the reference is only to the spirit of the Marshall Plan—a large-scale focused effort, not unlike the call for a Marshall Plan for the central city. Sometimes a more literal comparison is intended: what worked for Western Europe in the late 1940s and early 1950s may be what Eastern Europe needs in the early 1990s. This paper is written mainly to clarify what the Marshall Plan was and how it operated.

The Marshall Plan did not inaugurate American foreign aid. Lend-Lease to Britain and the Soviet Union and a few other countries had amounted to almost $50 billion by the end of the war, at a time when U.S. annual GNP was about $175 billion; Lend-Lease was about one-sixth of total U.S. World War II expenditures. (Subtracting “reverse lend-lease” and some repayment, the net cost was $27 billion.) After the war, relief and rehabilitation programs amounted to approximately $16 billion before the inauguration of the Marshall Plan. Furthermore, after the beginning of the Marshall Plan in April 1948, other aid programs, mainly outside Europe, continued.

The Marshall Plan was differentiated from other aid programs in that it was indeed a “plan.” Other aid had been given as necessary for relief and rehabilitation and for assistance in occupied Germany and Japan and to stabilize the pound sterling; the Marshall Plan was to have a beginning and an end. The economic problem of Western Europe was believed to be finite and solvable. The United States called on the countries of Western Europe to put together a plan not just for receiving U.S. aid, but for recovering economic independence within a foreseeable period. The governments of Western Europe were expected to demonstrate not only what aid they needed from the United States but how, with U.S. aid, they could complete their recovery from World War II.

It was furthermore to be a European plan, not 15 national plans. It was to be European in two respects. One was that trade among the

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countries of Western Europe was exceedingly constrained by a system of bilateral trade negotiations, usually constrained by the need for bilateral balance; more flexible, more market-determined, more multilateral trade was considered essential to Europe's recovery, and the expansion and multilateralization of intra-European trade was to be a central part of the plan.

The other respect in which it was to be a European plan was that the potential recipients, immediately after George Marshall’s commencement address, were to put together a joint plan indicating the amount of aid they would collectively need in order to complete timely recovery. Each nation's requirements were scrutinized and cross-examined by the other European nations. An exorbitant claim by one nation was perceived to be a threat to the aid that the others could receive, and the result was a negotiated total.

After the funds were appropriated and became available, the Committee for European Economic Cooperation became the Organization for European Economic Cooperation (OEEC) and was immediately given the task of proposing the appropriate breakdown of the second year's aid among recipient countries. The word “cooperation” in the titles of both the European organization and the U.S. Economic Cooperation Administration (ECA) was taken seriously.

The notion of a "plan" was reflected in the institutional arrangements. The OEEC was located in Paris, and so was the U.S. ECA's overseas central office. Additionally, the United States had in each country an ECA mission, attached to the embassy. Each mission dealt directly with the national government on matters concerning aid. Each mission worked with the government in developing its plans and estimates for the following year. The same operating procedures were followed in each of the recipient countries.

With the exception of occupied Germany, for each aid recipient U.S. aid was the dominant relationship with the United States. It was not merely another dimension of diplomacy. For most or all of these countries the most difficult problem of economic management was their balance of payments with those areas of the world from which imports had to be paid for in dollars, or for those commodities from anywhere that had to be paid for in dollars. Depending on the country, U.S. aid covered somewhere between one-third and three-quarters of dollar imports. U.S. annual aid to Europe in this program was about $4 billion, about 1.5 percent of GNP. That percentage would amount to about $75 billion now.
For the European countries the significance of the aid was usually measured in terms of the fraction of dollar imports that it covered; translating the dollar amount into percentages of GNP depended on the exchange rate used. To illustrate, Britain received $1.2 billion during 1948–1949; at the exchange prevailing at the beginning of the year, $4.09 to the pound, this was 300 million pounds or approximately 2.5 percent of Britain’s gross national product of 12 billion pounds. In September 1949, after devaluation, the same dollar amount was 430 million pounds, or 3.5 percent of the same GNP. The pound was still substantially overvalued; an equilibrium exchange rate in the presence of U.S. aid might well have brought the aid figure to 5 percent of GNP, and an equilibrium exchange rate in the absence of aid, used as a measure, would have put the percentage even higher. Probably for Western Europe as a whole, a figure somewhat upwards of 5 percent is reasonable. Comparisons with GNP were not commonly made.

The aid was all “government to government.” A small part was in the form of loans; most of it was grants. In principle, the aid amounted to a grant to the central bank of the recipient country. For practical purposes one can think of the aid as being commingled with other dollar resources available to the central bank, to sell to importers who paid their own local currency to the central bank and spent the dollars on imports. Virtually none of the aid was earmarked for particular activities or projects in the recipient countries. Later, beginning in 1951, there would be a strong identification with military procurement and construction, but during the Marshall Plan years the aid did not explicitly go to railroads, manufacturing, housing, animal stocks, or consumption. It simply filled a “gap” between the dollar imports that were deemed necessary for economic progress and the dollar earnings from all sources (not excluding drawdown of reserves) that could reasonably be expected. (There were a very few minor attempts to get U.S. aid directly identified with specific projects—workers’ housing in France, or projects undertaken jointly by two or more countries—but such internal targeting had nothing to do with what the U.S. dollars were spent on.)

PROCUREMENT AUTHORIZATIONS AND COUNTERPART FUNDS

The actual technique for dispensing aid was not nearly as simple as a straightforward grant to a central bank, and it is of some interest to examine how the technique may have influenced results. The money for each country was essentially earmarked at the U.S. Treasury.
When, say, a Dutch importer went to his bank for foreign exchange, presenting a valid import license—all these countries had exchange controls, and foreign exchange could be procured only by an importer with a valid license specifying the commodity and the country source—his bank would obtain through the central bank either dollars from the foreign exchange reserves or a “procurement authorization,” or PA, issued by the Economic Cooperation Administration. This was essentially a voucher that the U.S. exporter could cash at the U.S. Treasury. To the importer it usually made no difference whether he had a draft on an American bank or a PA.

Meanwhile, back at the bank, the local currency that the importer paid to get the PA was sequestered into an account called the “counterpart fund.” These funds were the property of the government, but according to the bilateral agreement covering the entire aid arrangement, the counterpart funds could be spent only by agreement with the United States. The United States could veto the use of the funds but could not require the use of the funds. (Five percent of the counterpart funds were separated into an account that could be directly used by the United States for administrative and other purposes directly related to the Marshall Plan. The most remembered use of this “5 percent account” was restaurant meals.)

An interesting question is why the PA system was instituted. Another question is what difference it made. The 1946 stabilization loan to Britain was a straightforward line of credit. But the difference could not be between loans and grants, because the small loan portion of the Marshall Plan was subject to the same procedures as the grants portion. The Congress evidently did not like the idea of making outright grants to Greece or Italy or France, preferring something like “aid in kind” for purposes of paternalistic and other controls. The second question is what kind of control this constituted and how it was used.

**PAs As Control**

In none of the country programs that were submitted to OEBC for scrutiny and cross examination, and in none of the tentative country programs that were discussed with the country ECA missions, was the slightest attention ever paid to the PA procedure. Every mission had a program officer and a finance officer, and some of the larger missions had industry representatives, agriculture representatives, and labor representatives, who served much like attachés. Every mission also had a comptroller, who concerned himself with monitoring procurement operations. Nobody else in the mission paid atten-
tion to the issuance of procurement authorizations. The PA procedure was not used to assert any kind of program control or any control over what the countries imported with their dollars.

The PA procedure made it possible to identify for the Congress the specific imports that the U.S. aid had "paid for." It was a way of making the aid dollars appear not to be fungible with other dollars available at the central banks. If Congress considered nylon a luxury, as on one occasion it did, and thought nylon should not be financed under the Marshall Plan, the ECA could refuse to issue PAs for nylon. The country could then procure the nylon from its own dollar reserves. That much was window dressing.

Congress did exert pressure on European imports. The PA system may have been moderately useful to the Congress in applying pressure. Congress wanted Europe to import more American tobacco; it may have been slightly helpful if Congress, in overseeing the program, could demand that more PAs be issued for American tobacco. Congress did require that half of all aid shipments be in American ships, but PAs were unnecessary to police that; and initially there were restrictions on the export of agricultural machinery, which was in short supply in the United States, but again the PA system probably didn't contribute to monitoring those exports. Possibly the PA system helped prevent fraud, and maybe central banks welcomed the system for that reason, although this is only a guess.

THE STRATEGY OF CONTROL

There is a lesson here, perhaps, on how to "control" the use of aid money. It is sometimes thought, when one cannot entirely trust an aid recipient to make the best use of that aid as the grantor defines "best use"—whether the recipient is a foreign country, cities, families, universities, or even one's own children—that the aid money should be spent on the hard-core necessities. But if hard-core necessities are things so necessary that they would be the highest priority purchases of the recipient anyway, that criterion simply leaves all the discretion to the receiving party, who determines how to spend all the discretionary funds. If the only way to exercise control is by determining what the aid money is spent for, it is best to estimate the resources available to the recipient, identify the things that the recipient cannot possibly do without, match those things against the recipient's own resources, treat one's own funds as the marginal funds, and allocate them in accordance with the donor's preferences, not the preferences of the recipient. If a parent is going to pay two-thirds of a child's college expenses and tuition amounts to two-thirds
of his or her total expenses, and if tuition absolutely has to be paid, paying the tuition simply means that the child's own resources, one-third of the total, will be spent as he or she pleases. If instead the parent pays half the tuition and procures, with the other half of the aid, the child's room, board, clothing, entertainment, haircuts, athletic facilities, books, soap, and toothpaste, the "donor" completely determines the child's lifestyle (unless he or she can trade away the toothpaste and classical concert tickets for marijuana and a rock concert).

But there is a better way, better in terms of relations between the grantor and the recipient, and that's the way it was done in the Marshall Plan. It's the way it would be if the parent and the child had a common understanding of the resources available to the child and jointly worked out the child's needs, starting with tuition and going on through room and board and all the other things that the college child needs to spend money on. Together the parent and child work out a budget; the two may argue about buying books or using the library, about the quality of room and board and meals out, about vacations away, about clothing or camera film and everything else, but eventually they negotiate an overall budget to which the parent contributes his or her share. Now, of course, the parent needs either an honor system or a way to monitor the child's actual expenditures.

In the European case, the overall programs were negotiated, substantially among the European countries themselves as part of the aid division process, including how they would allocate, among broad categories of goods, the dollars they expected to be available. When the United States was reasonably content with these overall "budgets," it then didn't care which commodities were bought with which dollars. It could monitor the country's use of its dollar resources, and substantial departures from the original budget could be negotiated or discussed in the course of the year. The country's own statistics on imports and the issuance of import licenses were important if one wanted to monitor overall transactions; the PA system was no particular help. The extent to which the United States intervened in the countries' imports during the year varied, from much in Greece to little or none in the United Kingdom.

**COMMODITY COMPOSITION OF AID**

The commodity composition of European dollar imports is interesting. There is sometimes a naive expectation that aid for a postwar recovery program, with high levels of investment expected in the recovering countries, should consist largely of things that look like capital
goods. There is similarly an expectation that aid in support of a military buildup will consist mainly of things that look military. In the first 15 months of the Marshall Plan, however, machinery and vehicles accounted for only 8 percent of the funds. Raw materials and semifinished products were only about a quarter of the total. Nearly 60 percent was food, feed, fertilizer and fuel. Four years later, when economic assistance was being given in support of the defense programs of the NATO countries, one might have expected the program to consist of metals, machinery, and the other items that contribute to defense production; but food, feed, fertilizer, and fuel accounted for two-fifths of the total. The raw materials would not have appeared to be especially related to military production.

This of course is just a reflection of comparative advantage. Most reconstruction requires local resources. Dredging canals, restoring roadbeds, building and rebuilding housing and factories all require domestic labor. And they require fuel for vehicles and for electricity. A significant part of capital investment is increasing the stock of farm animals; the feedstuffs had a large investment component as animal stocks were built up.

The same is true of a military buildup. Armies need the people who would otherwise be in the civilian labor force, need to house them and transport them and equip them. Armies need vehicles and ammunition and other things that are rather low technology. Supporting the NATO buildup was not altogether different from supporting the rebuilding of the European economies. Comparative advantage determines the contents of the dollar imports, and the only reason to expect "military aid" to contain military equipment would have been either the need for high-technology equipment that only the United States could produce, or military surplus equipment disposed of as the U.S. modernized its own forces.

COUNTERPART FUNDS AS LEVERAGE

As with the procurement authorizations, the question arises over what use the U.S. government could make of its nominal joint control over the counterpart funds. If a country has a modern central bank fully integrated into the government, as was the case in the United Kingdom but not in all countries, counterpart funds should represent merely a bookkeeping entry. If the central bank holds government notes, they can be cancelled against the counterpart funds, and the counterpart funds disappear. Anytime the government might want to spend counterpart funds, it could as readily obtain credit from the bank and let the counterpart funds sit in an idle account. In terms of
“functional finance,” the counterpart funds should have no economic significance whatsoever.

But the bilateral agreement, by providing that these funds should be sequestered and utilized only as jointly agreed with the United States, provided a kind of legal justification for the United States to engage the government in discussion of its fiscal and monetary policies. If the United States considered a country’s fiscal and monetary policy too expansionary, it could open discussion of the government’s planned use of counterpart funds, and that kind of discussion could take place only in the context of the government’s overall fiscal and monetary policies. The U.S. interest in engaging in such discussions differed from country to country, but counterpart funds were a kind of diplomatic entry into a government’s budget plans.

But even a government as financially sophisticated as that of the United Kingdom could not quite ignore the counterpart funds. Britain had a Labor government, and the party’s backbenchers were always more liberal in their spending philosophy than the government; to them, the counterpart funds looked like money just waiting to be spent. The government could argue that if its budget and revenues were optimized with respect to employment and inflation, the counterpart funds were not real resources and spending them would be no different from getting a new line of credit from the Bank of England and spending that. But the argument did not satisfy the backbenchers, and the British government proposed to the United States that the counterpart funds be cancelled against equivalent government debt at the Bank of England and thus made to disappear. This raised a counterpart problem in the U.S. Congress, where some representatives and senators had opposed the nationalization of British transport and mining, which had been financed through the central bank, and didn’t want Marshall Plan funds used to pay for the nationalization of industry. Thus the British government proposal to wipe out the counterpart funds by offsetting them against debt found itself caught between its own party members and U.S. congressmen, both of whom took the counterpart funds to be “real.” I do not remember how that one came out.

Occasionally the United States and the recipient government could jointly make political use of the counterpart funds. Typically, in a cabinet-style government there are pressures for expenditures in different directions, some budget programs are popular and some are not, and the government may wish to promote certain activities and soft-pedal others. By getting the United States to indicate that
counterpart funds would be readily released for certain expenditures that the government and the United States believed deserved support and that counterpart funds could not be released for various other purposes, the government had more bargaining power over the programs it preferred. The United States served as a scapegoat.

There were countries whose monetary systems made access to central bank credit difficult for the government. Turkey was one. In the "defense support" stage of economic aid for Europe, beginning fiscal year 1951–1952, aid was occasionally granted for the explicit purpose of allowing a higher level of government domestic expenditure. Among administrators this was referred to as "budgetary support." It was invariably in connection with enlarged military expenditure. Here, again, it was not enough merely to demand that the counterpart funds be directed to military purposes. There had to be an understanding of what military outlays would be in the absence of aid and what they would be in the presence of aid, with an ability to monitor the outcome; otherwise the substitution effect could have destroyed any relation between the aid and an increment in military spending.

**DEFENSE SUPPORT**

The widespread belief that the net effect of an expenditure is revealed by what is purchased with the money was remarkably persistent, and it allowed the executive branch to engage successfully in something close to deceit. When the Economic Recovery Act was supplanted in 1951 by the Mutual Security Act, and the aid for Europe that was not military equipment was named "defense support," the executive branch was able to identify increased domestic military expenditure in the European countries as the direct result of dollar aid. To some extent, the allocation of counterpart funds to defense helped make the connection. But as the Congress became less and less interested in what it called "economic aid" and more interested in what it called "military aid," and the executive branch wanted to provide more dollar assistance than the Congress would provide, military aid funds were used for OSP—"offshore procurement." OSP was simply the purchase of military equipment in Europe to be delivered to the military forces of the European countries. Just as the PAs were identified with specific commodity imports, OSP was specifically identified, dollar for dollar, with military equipment delivered at U.S. expense to European armies. As far as the central bank was concerned, "exporting" military equipment to the United States for delivery to NATO had the same effect as if equivalent dollars had been provided.
at the central bank and counterpart funds had been spent on the equipment, or as if the old PA procedure had been used and the counterpart funds so spent.

OSP initially envisioned buying equipment in one country for delivery to another, but even that facade was not maintained as equipment was procured in France for delivery to France.

The war in Indochina was especially popular with the Congress. To help relieve the French dollar balance of payments, the U.S. aid program—with "military assistance" dollars—picked up the tab for all kinds of supplies being shipped to the French forces in Indochina, amounting to more than $1 billion. The United States paid no attention to what was actually "purchased"; the whole object was simply to pick up the tab for enough expenditure to relieve the French balance of payments deficit. If the Congress had found the construction of schools and hospitals to be more popular than Indochina, the United States could have picked up the tab for schools and hospitals—as long as the schools and hospitals were going to be built anyway—and the war in Indochina would have been financed out of the defense budget. Either way, the Bank of France would have received the same dollars to dispense to French importers.

INTEGRATION AND UNIFICATION

At the outset of the Marshall Plan there were some high expectations of West European unification, economic and political, to be arrived at through the kind of cooperation that the administration of the Marshall Plan might enforce. Except in France, where Robert Schummann was busy putting together the Coal and Steel Community, the interest in unification died away. It continued to be a major preoccupation of many people administering the Marshall Plan in Washington but not among the people administering the Marshall Plan in Europe. But there was one area where the United States did force a kind of "unification" on the Marshall Plan recipients. This was the area of European trade and payments.

Intra-European trade had continued to be constrained by bilateral agreements between governments. These were typically annually negotiated plans that specified values of imports in rather detailed categories. The agreements included possible swing credits and specifications of the currency in which any net balance beyond swing credits would be settled. The obligation a country incurred in the agreement was to issue import licenses up to the amount in each category to be imported from the partner country. No country's currency (except
Belgium's) was convertible into gold or dollars; a few had currencies that were "transferable" (convertible) into sterling. The whole arrangement was quite constricting on trade, and difficult to escape.

The European Payments Union was a U.S. idea for freeing up intra-European trade. It was to be a system in which all bilateral trade accounts would go through a central clearinghouse where accounts, though not convertible into dollars, would be kept in dollar-equivalent values. To overcome any European reluctance to set up such a system, the Economic Cooperation Administration asked the Congress to set aside $300 million out of the aid total to be available only for initial financing of a European Payments Union. The $300 million was too good to let go, and the European governments took the bait; negotiations throughout 1950 led to the creation of the European Payments Union.

European payments were still "planned" but became more flexible. U.S. aid could now be conditioned on a recipient country's extending "drawing rights" to the payments union. Drawing rights were simply claims on the country's currency. As an accounting matter, some fraction of the counterpart funds was made available to the European Payments Union with which to settle the union's deficit with that country. The $300 million could be used to procure drawing rights. An equivalent total of drawing rights was then extended to countries expected to be in an intra-European deficit. The new system was a long way from free trade and convertible currencies, but it was an important beginning, and it was entirely at the initiative of the United States and would not have come about without U.S. insistence.

EXCHANGE RATES

A mystery on which I can shed no light is the almost complete inattention at the time to exchange rates. With all of that U.S. aid being determined by, and focused on, estimated dollar deficits, with all of the economic inefficiencies likely to be present with exchange controls and administered licensing of trade, a central issue should have been the appropriate rates of exchange between those currencies and the dollar. In more than two years in Europe, from September 1948 to December 1950, the only reference I ever heard to free exchange rates was a question raised by Milton Friedman during a brief visit. But, more important, I never heard or saw reference to any discussion of what an appropriate level of administered exchange rates might be. Of course, exchange rates are a volatile subject, and if the United States were leaning on a European government to devalue, it would try to do it in the greatest secrecy. But one would think in designing
both the philosophy and the details of a European Payments Union 
the concerned American officials would at least discuss among them- 
selves the prospects for European currency devaluations and how 
badly they were needed and to what levels they might go. If there 
had been such discussions I would have heard them. One would 
probably not expect open discussions in the OEEC about each other's 
exchange rates, but still one might expect some very general discus-
sion about the need for realigning exchange rates. I heard none and 
saw none.

Maybe it was the imposing presence of Bretton Woods: exchange 
rates were not to be fooled with. I think it was just neglect. Partly it 
may have been that most of the American economists who went to 
Europe with the Marshall Plan or worked in Washington with the 
Marshall Plan were not international trade and finance economists. 
Whatever the explanation, it was a monumental blindness that 
persisted for several years.

UNITED STATES AS SOLE SOURCE

An enormous difference between now and then is that the United 
States was the sole source of aid, indeed the sole source of dollar capi-
tal inflow. The United States was in complete command. There was 
no need to coordinate with or compete with other grantors; recipients 
couldn't play one grantor off against another (the way developing 
countries later played the United States and the USSR off against 
each other as aid grantors). There was no grantor strategy of leaving 
certain countries unattended or certain needs unmet in order to 
pressure some other grantor into making up the difference. There 
was no congressional concern about what other grantors were or were 
not meeting their fair share of the burden. There was no jockeying 
for preferred position as major exporter to particular recipient 
countries.

ANTIINFLATIONARY AID

U.S. aid was antiinflationary in two ways. It substantially enhanced 
domestic production of consumer goods by providing critical raw ma-
terials. (Food in the form of grain is a raw material, as is fuel for gen-
eration of electricity.) And the import surplus financed by U.S. aid 
directly absorbed significant purchasing power. (It would have 
absorbed more if exchange rates had been cut in half.) Raising con-
sumption was more critical in some countries than in others;
improved living standards in Italy, for example, may have had important domestic political repercussions and weakened the communist party. Increased consumption may appear to be a transient benefit; but then maybe the boost in the availability of consumer goods in an East European country can help a government through a critical year or two with both higher living standards and reduced inflationary pressure.

There was private capital inflow from the United States to Western Europe, largely from companies that had operated in Europe before the war, often taking the form of equipping or modernizing American-owned facilities. It was small compared with U.S. aid. The reverse may possibly be true in Eastern Europe.

CRITERIA FOR AID

There was never a formula for distributing Marshall Plan dollars; there was never an explicit criterion such as equalizing living standards, equalizing growth rates, maximizing aggregate output or aggregate growth, or establishing a floor under levels of living. Baseline dollar-balance-of-payments deficits were a point of departure, but the negotiations took into account investment needs, traditional consumption levels, inherited technologies and industry-agriculture mix, war-induced capital needs, opportunities for import substitution and export promotion, and opportunities to substitute intra-European trade for trade with hard currency countries. These were the considerations that entered into the negotiations, but there was nothing like a formula. Aid per capita was never paid much attention. All of these considerations were drawn into a focus on the dollar balance of payments. And what was scrutinized in the OECD negotiations and scrutinized by the United States was not the use to which aid was specifically to be put but the entire program of proposed dollar imports. With a very few unimportant exceptions, none of the aid was directly targeted on “projects” or particular industries or particular kinds of infrastructure. That changed when the Korean war activated NATO and the name of the Act was changed from “Economic Recovery” to “Mutual Security.” Aid was then negotiated directly against defense buildup programs. But except for the window dressing of counterpart funds being used in defense budgets, the aid itself was not targeted at particular military objectives. Even the offshore procurement was opportunistic, although for a while it was thought that offshore procurement might be used to help standardize some NATO military equipment.
THE FORMS OF AID

People thinking of aid to Eastern Europe think of particular tasks that may need external financing: modernizing equipment, rebuilding infrastructure, replacing obsolete factories, modernizing production of electricity, chemicals, metals, etc. If that is the approach taken, then all of that fuss with procurement authorizations can be dispensed with. But there remains a choice. U.S. aid can be directed to particular urgent government projects, like sewage systems, which might or might not be going to get financed anyway; and, by the substitution principle, the main impact simply may be that the government acquired dollar assets while proceeding with the sewage project that was so urgent it had to be undertaken anyhow. The United States could alternatively require a government to submit an investment program for the coming year or two years or three years, with an incremental indication of what could be done with U.S. aid and what could be done without it; the United States could then scrutinize the resources available to the government and the investment needs and negotiate a government investment program of which U.S. aid would finance a portion of the total. Again, the United States might offer dollars to a government, which would make loans on the basis of those dollars to private business, with the United States either supervising the selection of particular projects or going through a "plan" of all expected private investment with a negotiated agreement of what might be included in an enlarged plan incrementally financed by U.S. aid.

The United States could, of course, agree to finance only the imported components of some incremental public-private investment plan, but in a period when trade negotiations are in some disarray, trade rivalries are great, and there is great attention on the U.S. balance of payments, that kind of programming, especially if a system like procurement authorization were resurrected, might focus too much congressional and public attention on U.S. exports.

The Congress may in the end leave no choice but to finance only, or almost only, U.S. exports, especially if Japanese grants or loans to Eastern Europe are tied to Japanese goods and services. In that case, the Marshall Plan experience reminds us that what is directly financed with the U.S. dollars will bear little or no relation to what is being constructed or modernized in the recipient country. If the Congress wants an accounting connection between the U.S. aid and tangible projects, the counterpart funds arrangement or something like it will serve the purpose.
THE TIME DIMENSION AND FLEXIBILITY

In the Marshall Plan, the U.S. aid was matched against an agreed estimate of a country's "need" for additional dollar imports. The budgeting period was the year. Whether the actual "need" proved to be close to the estimate depended on a number of factors, some of which were and some of which were not within the control of, or subject to the influence of, the recipient country. For example, the estimates took into account the expected success of export promotion and import substitution, availabilities from nondollar sources, internal rationing, and overall fiscal policy. A major strategic issue was how rigidly or how flexibly to adhere to the original figure as the year developed and as the discrepancy arose between the initial plan and the experienced "need." The issue was never satisfactorily resolved. The argument for flexibility is that there were too many uncertainties to expect actual need to correspond with a year's forecast; even if all quantitative projections proved correct, there could be variations in the prices paid for dollar imports. There was also an argument for holding to the plan and not bailing out a country that got into unanticipated difficulty, and not attempting to recapture allotted aid if a country's exports did better than expected: namely, to provide an incentive for the recipient government, and to avoid the difficulty of sitting in perpetual judgment on countries' performance, as the years went by. One thing that was not done was to withhold a reserve for major contingencies. Had a quarter or a fifth of the total been set aside and not "programmed" to particular countries, there might have been an unmanageable incentive for recipient governments to develop unexpected needs early in the year before other governments had drawn down the reserve with a demonstration of their own needs.

NEIGHBORLY COMPARISONS

Not only the Marshall Plan but aid to India and Pakistan, aid to Israel and some Arab countries, even aid to Italy and Yugoslavia, led to invidious comparisons. The comparisons were less troublesome in Europe than in other areas, partly because there were neither political hostilities nor military rivalries. I do not remember any particular resentment of aid to Germany at the time. A question that may arise is whether U.S. aid for Eastern Europe should be handled strictly bilaterally, with aid to one country insulated as much as possible from aid to any other in the region. There were great advantages, especially for the ensuing cooperation in NATO, of having made the Marshall Plan a team effort; I don't perceive obvious corresponding advantages in the Eastern European setting, and the
potential disadvantage is the greater opportunity for rivalry when aid to two or more countries is constrained by a common overall total. A way to minimize invidious comparison may be to avoid synchronizing individual aid programs in a common calendar. The Marshall Plan, after a slightly irregular start in early April, marched to a regular fiscal year calendar. An implication of awarding aid for a fiscal year is the expectation of continued aid in the next fiscal year. There is no strong reason why aid should be programmed on an annual basis. (I do not believe the World Bank does it that way.) In principle, one could establish a fixed sum to be exhausted on some agreed schedule, with funds perhaps appropriated annually but always against a previously established ultimate ceiling.

One of the lessons from the Marshall Plan is that it is exceedingly difficult to terminate aid. The temptation is to taper it off indefinitely. The termination of an aid program is often construed as the severance of a relationship, a termination of interest in how the country is doing economically. And no matter how ceremonially one tries to establish the finality of a lump-sum aid figure, no recipient will ever believe that more will not be forthcoming if it is needed badly enough.
3. AID FOR EASTERN EUROPE: A SKEPTIC'S VIEW

Nicholas Eberstadt

The collapse of Soviet power in Central and Eastern Europe may well have propelled those newly liberated countries into an era not only of change but of uncertainty. Yet one implication of the "revolutions of 1989" was immediately clear: the region would soon have a "development assistance" program of foreign aid from the United States. Since the late 1940s, when the United States invented this utterly new form of statecraft, American policymakers have striven to promote self-sustaining economic growth and liberal democratic rule through long-term, government-to-government resource transfers in literally dozens of countries around the world.

Sure enough: at this writing, the United States is attempting to fashion such an aid program for Eastern Europe's new governments. Though many of its details have yet to be formalized, or even announced, this program promises to be a major undertaking. It also proposes to affect a great number of people. Excluding eastern Germany (now the Federal Republic's responsibility), the population of the region numbers nearly one hundred million. That total does not count Albania and Yugoslavia, though these countries could eventually be inducted into the new programs as well.

On the eve of this new aid initiative, it may be appropriate not only to consider the particulars and prospects for a still embryonic program, but to reflect more generally on the performance of American "development assistance" to date.

A THOUGHT EXPERIMENT

We can begin our review with a simple "thought experiment." What would we expect the economies, societies, and polities of Eastern Europe to look like in 1990 if those five countries had instead all been

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recipients of American “development assistance” over the previous two decades?

Like all such experiments, this one is speculative, and thus perhaps necessarily inconclusive. But we can perhaps pursue our experiment by comparing various characteristics of the countries of Eastern Europe immediately after their “revolutions of 1989” and those of the dozens of African, Asian, and Latin American countries that enjoyed steady flows of bilateral American “development assistance” funding during the 1970s and 1980s—especially those characteristics bearing on what might be called “economic health.”

One strikingly “unhealthy” characteristic of the East European states was their inability to manage their external debts. Over the course of the 1980s, the relationship between these then-communist states and the international economy revealed itself to be increasingly dysfunctional. Their problems in coping with external commerce and finance were illustrated, and underscored, by “debt crises.” The governments of Poland and Romania (and also Yugoslavia) not only failed to repay their international creditors on the schedules they were contractually committed to, but sought and obtained “debt relief” agreements from them. At the time of its liquidation, the international finances of Hungary’s communist government had also become precarious. After the German Democratic Republic’s collapse, previously secret documents showed that the state’s external hard currency debts were nearly twice as great as officially acknowledged. And a few months after the demise of the Zhivkov regime, Bulgaria suspended its repayments of both interest and principal to its hard-currency creditors.

These debt difficulties were systemic: that is to say, they were centrally affected by the policies and practices of the governments in question. For as Roland Vaubel has observed, “The ultimate criterion of whether debt servicing has become more difficult or not is whether the borrower’s rate of return exceeds the interest he has to pay. . . . It depends on the use of the funds.”

During the 1980s, “debt crises” were also characteristic of the states that had been long-term recipients of bilateral American “development assistance.” In the mid-1980s, by the U.S. government’s count, 74 countries in Africa, Asia, Latin America, and the Caribbean were receiving direct economic assistance from the U.S.

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Agency for International Development (USAID); almost all of them had been receiving such aid in the early 1970s and continued to receive it in the early 1980s. By the World Bank's count, 45 of those 74 countries negotiated debt relief agreements during the 1980s alone. Compounding the financial difficulties of Eastern Europe's communist states was their determination to maintain "nonconvertible" currencies: that is, to guarantee the validity of the money they printed only for international transactions they specifically approved. Though Hungary attempted a regimen of "limited convertibility," for all practical purposes the currencies of Eastern Europe were nearly worthless in the open market before 1989. Indeed, they were designed to be. "Nonconvertibility," as intended, restricted the role of international trade in the local economy.

Nonconvertibility, or limited convertibility, is also characteristic of the currencies minted by the states that have been receiving economic assistance from the United States over the past two decades. A qualification may be in order here. Demonstrating the soundness of a country's money has been problematic since the Smithsonian Agreements of the early 1970s; today, no governments honor the gold standard unconditionally. Even so, one may note that few "Third World" treasuries manage to keep themselves afloat in our era of "floating" exchange rates. By the International Monetary Fund's (IMF's) count, only 10 of the more than 70 countries today receiving bilateral economic assistance from the United States are deemed to have "independently floating" (that is, spontaneously convertible) currencies—and there are reasons to believe this may be a generous estimate.

In any event, the trade exposure of many long-term U.S. aid recipients appears to be as limited as that of Eastern Europe's economies—in some cases, even more so. By the most recent (though hardly perfect) estimates of the World Bank, the ratio of exports to gross domestic product in 1988 was higher for Hungary than for Haiti, Bolivia, or Paraguay—smaller and ostensibly poorer countries, for whom the benefits of increased trade participation should be self-evident. Sub-Saharan Africa, for its part, is said to maintain a ratio

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of exports to outputs that is no higher than Poland’s—indeed lower, if 
the region’s most populous country (Nigeria) is excluded from the 
grouping.

In the late 1980s, Central and Eastern Europe were still ranking 
members in the “distorted world of Soviet-type economies,” to borrow 
an apt phrase from Jan Winiecki. They bore the scars of decades of 
socialist central planning, and suffered its disfigurements. The struc-
tures of their economies had been severely deformed. Their central 
governments had arrogated utterly dominant roles for themselves 
within the local economy. They had amassed vast networks of state-
owned enterprises. Without regard to consumers, these governments 
had directed forced-pace transitions out of agriculture and into state-
owned heavy industries. They depressed private consumption and 
diverted funds into state “investment,” not on the basis of economic 
calculation, but as a matter of political principle.

The fact of these far-reaching distortions is no longer contested—least 
of all by the peoples upon whose economies they were wrought. But 
parallel distortions are just as evident in the economies of long-term 
recipients of American aid.

Figures compiled by the World Bank and the IMF make the point.6 
According to the IMF, for example, central government expendi-
tures accounted for about 40 percent of gross domestic product in Poland 
and Romania in the late 1980s, and for over 50 percent in Hungary. 
These are high shares by any international measure. Yet they are 
not out of keeping with the estimates for some of the long-term 
“development assistance” countries. According to IMF figures, for ex-
ample, the ratio of central government spending to national output in 
Egypt—the principal U.S. aid recipient in Africa—was about the 
same as in Poland or Romania during the 1980s. The Comoros, 
Jamaica, Jordan, Tunisia, Zambia, and Zimbabwe are some of the 
other long-term recipients whose ratios of central spending to output 
seem roughly to match Poland’s and Romania’s. The annual figures 
for the Seychelles (another long-term recipient of U.S. “development 
assistance”) are generally higher than Hungary’s. Moreover, the 
IMF’s highest published ratio (a seemingly impossible 108 percent) is 
for Guinea-Bissau—another long-term recipient of U.S. economic aid.

5Like Haiti, Bolivia, and Paraguay, virtually all the countries in the sub-Saharan are 
long-term recipients of American “development assistance.”

6One need not vouchsafe the accuracy of these estimates for our purposes; they 
merely illustrate our argument with the data most frequently cited in discussions of 
“development economics.”
By the same token, the war against agriculture, and against the consumer, looks to have been taken even further in some recipient countries than in Soviet-occupied Europe. The World Bank estimates that agriculture accounted for roughly one-seventh of Hungary's output in 1988. By the Bank's reckoning, the share of agriculture in the economies of Zimbabwe, Jamaica, Peru, and Jordan were all lower—even though those societies were also said to be poorer than Hungary. Conversely, the share of output accruing to industry is said to be lower in Hungary than in such places as Zambia and Haiti, even though these long-term recipients are thought to be much less prosperous. While apparently impoverished, such long-term recipients as the People's Democratic Republic of the Congo and the Ivory Coast have nevertheless managed to achieve ratios of private consumption to national product nearly as low as in Jaruszelewski's Poland. Another impoverished long-term recipient, Somalia, is said to have exceeded even Poland's inflated rate of gross domestic investment.7

For obvious reasons, the communist governments of Central and Eastern Europe did not attract significant quantities of foreign capital for direct private investment during the 1980s. Such inflows were also negligible for long-term recipients of American "development assistance" during those years. Indeed, though one could make too much of this fact, it appears that during the second part of the 1980s, Communist China succeeded in drawing more direct private investment from abroad into its officially protected enclaves ("Special Economic Zones") than those 70-odd Asian, African, and Latin American recipients of U.S. "development assistance" combined.8

Systemic inability to attract voluntary investment from abroad speaks to the "business climate" of the countries in question. When foreign capital is not accorded special, separate privileges (as it is in China today), such inability speaks broadly about the "climate" for the local populace as well. The factors affecting "business climate" are typically difficult to quantify, but no less important thereby. They include such things as the state of civil order, the extent to which law presides, and the degree of hostility toward the rights of the individual (including his right to property). Note that these factors bear di-


8Figures derived from OECD, Geographical Distribution of Financial Flows to Developing Countries 1985/88 (Paris: OECD, 1989). Estimates are for direct investment, 1985-88. By OECD's reckoning, China's net total for the period was around $1.6 billion; for the recipients of U.S. economic aid (excluding European countries), the total was negative.
rectly not only on commercial conditions, but on the quality of the civil and political liberties that the local citizenry may be said to enjoy.

One can, of course, identify a number of characteristic differences between the policies and practices of today's East European states on the one hand, and the group of states distinguished by their long-term participation in U.S. "development" programs on the other. But while a variety of characteristic differences may be noted between the countries of newly non-Soviet Europe and the group of long-term U.S. "development aid" recipients across Asia, Latin America, and Africa, what seems most striking is precisely the lack of distinct differences in so many important areas of policy and result.

It is true that our thought experiment did not look at aid from other Western countries or from international financial institutions, even though these bilateral and multilateral flows account for an increasing share of total concessional transfers. It also neglected the initial circumstances in these two groups of countries; consequently, we did not trace their actual "development paths." Our experiment nonetheless points to a fundamental question. If the conditions of the present states of Eastern Europe cannot be distinguished by such meaningful economic and political criteria from those under governments that have been obtaining American funds, and advice, for "development" those last few decades, why should U.S. aid and advice be expected to help Eastern Europe evolve away from its current characteristics—much less in the directions of self-sustaining economic growth or open, liberal politics?

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Not the least important of these pertains to population policy. By and large, Eastern Europe's governments embrace pronatalism, although the intensity and expense of their activities vary widely. Explicitly pronatal policies, by contrast, are rare among long-term recipients of U.S. "development assistance." Responding to a United Nations questionnaire, only two of these many governments (Equatorial Guinea and Israel) indicated that they viewed "interventions to lower fertility rates as appropriate"; by contrast, nearly 40 long-term recipients endorsed "interventions to raise fertility rates" in their countries. Derived from United Nations, *World Population Monitoring 1989* (New York: United Nations, 1990), table 34. This difference may in part reflect the impact of more than two decades of activity by USAID's energetic Office of Population, as one observer has noted, "AID's Office of Population had a single mission: to reduce the level of fertility in developing countries." Donald Warwick, *Bitter Pills: Population Policies and their Implementation in Eight Developing Countries* (New York: Cambridge University Press, 1982), p. 47. It may also be relevant that the Central European region's fertility rates had been close to, or below, net replacement since the early 1960s.
THE DECLINE OF AMERICAN FOREIGN ECONOMIC ASSISTANCE

The tragic fact is that American "development assistance" policies, for many years, have been more likely to lead a prospective beneficiary toward an East European-style economic morass than to help it escape from one. Though this assertion sounds hyperbolic, it is literally true. The case of the East European economies themselves, among others, attest to it. While the United States had no bilateral aid programs for Europe's Warsaw Pact states, it did engage some of them through its multilateral "development assistance" programs. The United States, after all, is the largest shareholder in the World Bank. In the years before the "revolutions of 1989," the World Bank extended to the communist governments of Hungary, Poland, and Romania a cumulative total of over $4 billion in loans—including loans for "policy reform": under American review, and sponsorship, the World Bank not only lavished these communist states with aid, but with praise of their policies and programs.\(^{10}\)

\(^{10}\)Two examples may suffice. The first is from the World Bank's only country study on Romania, which was published barely months before the government suspended payments on its foreign debt:

The major conclusion to be derived from a review of the past is that Romania, though still a developing country, has been successful so far in its development efforts and that the problems identified so far have not prevented targets from being carried out, although they may have increased the cost of meeting them. . . . It remains probable that Romania will continue to enjoy one of the highest growth rates among developing countries in the next decade (i.e., the 1980s) and that it will largely succeed in implementing its development targets. As a result of the comprehensive control of economic activities and the cautious policy of the government toward the use of foreign borrowing, external constraints will not reduce the country's creditworthiness. (Andreas C. Tsatsis and Roy Pepper, Coordinating Authors, Romania: The Industrialization of an Agrarian Economy Under Socialist Planning (Washington, D.C.: World Bank, 1979), pp. 11, 13.)

Here, nearly a decade later, is the Bank’s official assessment of Polish "reform" as of 1987:

The sweeping program of economic reform, which was officially adopted by a Party Congress in 1981, legislated during the Martial Law period, and recently reaffirmed in the "Theses on the Second Stage of the Economic Reform," is fundamentally well-conceived. . . . There is therefore reason to be optimistic that the adjustment path proposed is one that will, after a current account balance is reached, open the promise of a path of faster growth, greater competitiveness, greater potential for import liberalization, larger imports of machinery, faster technological progress, a more rapid improvement of living standards, and a smaller external debt. . . . If the present proposals can be fully and consistently implemented, they offer an opportunity for a major and lasting improvement in the efficiency, international competitiveness and growth of the Polish economy. (World Bank, Poland: Reform, Adjustment, and Growth, Vol. I (Washington, D.C.: World Bank, 1987), pp. xii, xviii, 198.)
How did U.S. development aid come to fall so far short of its stated aims of promoting economic health and self-sufficiency? By way of answer, we might recall some of the events that were instrumental in transforming America's foreign aid programs into a project with so very little to offer.11

In its early years, American development aid (or "technical assistance," as it was called at the time) was extended to governments in what was known as the "free world" to help them participate more fully in the liberal international economic order that had been created after World War II. To American policymakers, the primacy of private and commercial effort in the pending task of inculcating global prosperity was self-evident. So too, in their minds, was the link between government policies and local prospects for material advance. In a world newly complicated by both atomic weapons and the Cold War, exceptions to the rules governing such aid were sometimes declared and deviations from accepted practices were sometimes tolerated. They were, however, just that: exceptions and deviations. The objectives, and principles, of U.S. development aid were not in doubt.

American development assistance programs were tested by many minor challenges in the 1950s and 1960s, but they were shaken to their foundation by the Vietnam War. A confusion between political and economic objectives of foreign aid, already evident in the discussions that surrounded USAID's founding in 1961, was permanently impressed upon the agency by the Johnson administration's decision to harness it to the war-winning effort. The "development" programs that emerged in the field in response to these pressures—refugee relief, relocation projects, "pacification" programs, and the like—were not, in fact, meant to be judged by economic criteria. Severing the link between living standards of local populations and the productive capacities of their economies had previously been regarded as a matter of enormous practical and moral hazard; during Vietnam, U.S. aid programs embraced the principle of such a separation, and sought to enforce it widely in practice.

Ironically, the new approach to "development assistance" from Vietnam was soon globalized by American critics of the war itself. By the early 1970s, the U.S. foreign aid budget was the battlefield for a sort of guerrilla war against the president by a Congress discontented with the course and conduct of his Southeast Asian policy. After repeated failures to obtain its requested foreign aid appropriations, the

11For a more detailed account of these and other such events, see my Foreign Aid and American Purpose (Washington, D.C.: American Enterprise Institute, 1989).
Nixon administration agreed to a congressional rewriting of the aid mandate in 1973. This was the so-called New Directions legislation, which remains in force today. The New Directions language instructed USAID to focus its attention directly on the poorest of the poor: not only to reach them, but to "satisfy their basic needs and enable them to lead lives of decency, dignity, and hope."

This "Basic Human Needs Mandate," as it came to be known, not only authorized but seemingly required "development policy" to involve itself in the uplifting of local living standards through direct provision of goods and services—much as it had done in Vietnam. Though theoretical arguments were advanced to explain the contributions such activities would make toward the goal of self-sustaining development, the practical result was to mandate long-term relief programs for recipient populations. Perhaps significantly, the New Directions legislation did not require, or even urge, American development agencies to monitor the impact of recipient governments' policies and practices on the economies they supervised, even though that impact may have been of more than passing consequence to the circumstances of local populations (to say nothing of the most vulnerable elements within them).

With the "lessons of Vietnam" thus perversely codified into its new operating procedures, USAID commenced what may be described as an uninterrupted decline. Financial resources, to be sure, were at the ready: America's bilateral grants for "overseas development assistance" nearly doubled in real terms between 1973 and 1989, and public support for relieving the intense distress of the world's poor, to judge by opinion polls, remained abidingly strong. But the institutions administering development aid seemed beset by a sort of malaise. Changes in "institutional culture," though always hard to document, nevertheless seemed self-evident to many observers. Vietnam had taken its toll on USAID's morale and reputation; no longer could that agency expect to attract "the best and brightest," or even to retain those it already employed. But there was more. With the new "Basic Human Needs Mandate," recipient (and, ineluctably, constituent) services had become much more important; policy evaluation, correspondingly less so. In its first decades, the American aid program had prided itself on the quality of the advice it could dispense. In the 1950s, these American advisers had included some of the most successful captains of industry; in the 1960s, some of the finest minds from academia were among their numbers. After New Directions, the participation of such people no longer seemed so necessary; in any event, their views and assessments ceased being so-
licited in a regular manner. Such signals from the top necessarily af-

Although the Camp David Accords of 1978 called for substantial in-
creases in American foreign aid allocations, they also occasioned a
further diminution of the official capacity to administer “development
programs.” By the late 1970s, it would have been unthinkable to
submit the state of Israel to USAID’s ministrations—and equally un-
thinkable that Israel would have agreed to the Accords if USAID’s
services had been pressed on it as part of the bargain. The solution
was to arrange for direct budgetary transfers from the U.S. Treasury
to the Bank of Israel—completely circumventing the risk of advice or
visits from USAID personnel. Cairo, for its part, came to be the site
of a very large AID mission, but its busy regimen of project selection,
management, and review had all the trappings of a charade.
American aid officials, for the most part, could not hope to trace the
actual daily flows of the funds they transmitted (or the purposes
these actually served) when their counterparts wished for them to be
hidden. Moreover, Egyptian officials understood the simple truth
that Washington had predetermined each year’s aid authorization,
and that the local mission was obligated to release it in full. To
interfere with the aid flows to Cairo, no matter how ill-advised local
uses of those monies might be, would risk violating the Camp David
understanding, and thereby possibly threaten the foundations of
Israeli–Egyptian peace.

In barely three decades, American development aid programs, which
had originally been based on the premise of strict conditionality, had
become a vehicle for unconditional resource transfers. Within a
decade of Camp David, in fact, unconditional transfers were the rule
rather than the exception for American “foreign assistance.” By fiscal
year 1989, according to USAID’s own estimate, over 65 percent of its
grants to developing countries were from a special fund allocated ex-
pressly for political purposes, and authorization levels for particular

12If USAID was presenting a less welcoming invitation to the hard-edged busi-
nessman or the tough-minded policy analyst, it was, increasingly, a congenial home for
alumni of the Peace Corps program—and naturally enough, since their previous field
experience nicely meshed with the new specifications that had been laid down for
“development assistance.” (One top-level USAID official recently told me that an inter-
nal audit revealed that nearly three-fourths of the Agency’s senior personnel in 1989
were Peace Corps alumni. I have not seen those figures myself, however.) The emerg-
ence of USAID as a sort of safe haven for Peace Corps retrained, however, did not im-
prove the institution’s image or reputation among other international donors. Some
have argued that USAID officials faced a growing disdain by their international peers;
if this is true, it may have affected morale still further, and contributed to the ongoing
attrition of earlier personnel.
countries were "restricted," or predetermined, for all but 2 percent of those monies.\(^{13}\)

Given Ronald Reagan's rhetoric, his 1980 electoral victory might have been expected to presage far-reaching changes for the U.S. aid program. In fact, however, the Reagan administration did little to alter the substance or direction of "development assistance" programs. (His administration's two greatest interventions into existing operations—its cutoff of the annual $50 million bequest to the United Nations Population Fund (UNFPA) and its establishment of a tiny bureau of "Private Enterprise" within the huge USAID apparatus—may be fairly described as minor.)\(^{14}\) Whatever the reasons for this paradox, its consequences were clear. The capacity for, and even interest in, imposing conditionality on flows of "development assistance" did not recover. The sorry state of conditionality, in turn, brought "graduations" out of the U.S. aid program to a virtual end—despite the fact that "graduation," by its very nature, is one of the criteria by which the success of policies designed to promote self-sustaining economic development can be readily measured. In the 1960s, USAID could boast of such graduates as Taiwan and South Korea. In the 1970s and 1980s, its few "graduates" included Vietnam, Cambodia, Laos, and (for a time) Nicaragua. The circumstances of departure for these latter "graduates," one may note, had less to do with their economic "health" than with their new governments' attitudes toward America.

In 1989, an unusually frank report by USAID acknowledged these and other problems. According to the study (known as the "Woods Report," after the administrator who commissioned it during his brief tenure):

Somewhere between 1949 and the present, the original concept of development assistance as a transitional means of helping developing countries "meet their own needs" has been lost. . . . All too often, dependency seems to have won out over development. . . . Only a handful of countries that started receiving US assistance in the 1950s and 1960s


\(^{14}\)Some observers have attempted to explain this ominous paradox in terms of individual personalities. In a recent analysis, for example, two students of American "development assistance" credited Reagan's longtime AID administrator with "a skillful effort . . . to bridge the gap between the rhetoric of the more extreme right within the Reagan camp, the emphasis in the State Department on strategic considerations, and a personal commitment to the objectives of the [Basic Human Needs] Mandate." Mark F. McGuire and Vernon W. Rutan, "Lost Directions: US Foreign Assistance Policy Since New Directions," The Journal of Developing Areas, Vol. 23, No. 2 (1990), p. 186.
has ever graduated from dependent status. . . . Where development has worked, and is working, the key has been economic growth. And this is largely the result of individual nations making the right policy choices. . . . A strong, expanding American economy, a healthy trade climate, and the development assistance provided by profit-based and nonprofit private organizations are also critical elements. Direct US development assistance, overall, has played a secondary role. . . . Radically reshaping future official assistance programs . . . must be both an immediate concern and a major long-term national priority.\textsuperscript{15}

What of the role of American aid in fostering political "reforms" in recipient countries? Long-term receipt of American "development assistance" has certainly not prevented a transition toward a more open and participatory political order, as events in much of Latin America and the Caribbean in the 1980s were to attest. Similar transitions, however, took place in Latin countries that did not enjoy bilateral American economic aid programs at that time. Moreover, political tendencies among long-term recipients in other regions during the same decade were not characterized by corresponding liberalizations.

Unfortunately, the bilateral programs' economic record over the past generation seems fairly uniform, and the factors accounting for that performance look to be reasonably clear. At this juncture, an East European government seeking assistance (rather than simply cash) from America's existing aid apparatus might be judged as engaging in a singular act of faith, for there is little to suggest that these programs presently contribute to economic liberalization or development, and there is considerable evidence to the contrary.

FOREIGN AID "SUCCESS STORIES"

The record of America's postwar international economic policy is hardly one of unremitting failure. Quite the contrary: the postwar international framework that the United States helped to fashion and support is surely one of the more extraordinary successes in the history of international relations; indeed, it is one of the few whose accomplishments may have exceeded the hopes of its creators.

Moreover, specific American interventions are widely viewed as having evinced development from particularly troubled or unpromising locales. American assistance, for example, is today commonly described as instrumental to the postwar recoveries and expansions in Western Europe and Japan, and later in the dynamic growth of such "newly industrializing economies" as Taiwan and South Korea.

\textsuperscript{15} USAID, Development and the National Interest, pp. 111-113, 121.
Advocates of aid initiatives for Eastern Europe sometimes make their case by broad analogy with these earlier experiences. (The more sophisticated variant of the argument acknowledges some present shortcomings in the “development assistance” process, but suggests that local conditions in Eastern Europe are sufficiently propitious that the region may avoid the difficulties now characteristic of programs elsewhere.\footnote{This, for example, is the thrust of “The European Bank for Reconstruction and Development: The Central and Eastern European Markets,” by its president-designate, Jacques Attali (Vital Speeches of the Day, May 1, 1981, especially pp. 425–426), although his is naturally an argument for multilateral rather than bilateral aid.})

We shall examine some of these conditions in Eastern Europe itself in a moment. First, however, let us look at some of the particulars of the “success stories” ascribed to American economic development policy. How pertinent are they to “development assistance” programs as we know them today?

**Western Europe**

Like the words “democracy” and “free enterprise,” “the Marshall Plan” is a phrase that evokes a warm and favorable reaction from many audiences. Its popularity, in fact, is indicated by the very frequency with which it is used to describe new proposed programs of domestic or international public spending. But while the plan is often invoked in discussions of development aid, its actual objectives, applications, and results suffer from a strange neglect.

As its official name—the European Recovery Program (ERP)—reminds us, the Marshall Plan’s aim was to restore devastated economies. The stated objective was to help West European recipients reattain prewar levels of output. Although two decades of brisk and virtually uninterrupted economic expansion came on the heels of the plan, the ERP itself was not designed to foment “self-sustained growth.” Quite simply, it was not a program for “development.” Specific aspects of the Marshall Plan, moreover, raise questions about its actual contribution to the recovery.

Under Nazi occupation, the vanquished economies of Europe had been brought under a comprehensive system of controls, through which they were to be harnessed into the German war effort.\footnote{For a description of these arrangements, see Alan S. Milward, War, Economy, and Society 1939–1945 (Berkeley: University of California Press, 1977), Ch. 5.} After World War II, some of these controls stayed in place over most of the liberated economies. Moreover, the ECA (the American apparatus...
within the ERP) actually required recipient states to engage in economic planning in order to obtain their aid. Needless to say, this approach did not discourage statist impulses on the part of beneficiary governments. At the time, the governments of Western Europe embraced a variety of economic philosophies; naturally, reactions were not uniform. In more than one country, ECA aid was used to postpone rather than hasten economic adjustments or “privatizations,” while in Italy, there actually emerged the spectacle of a government struggling—against the wishes of its ECA financiers—to pursue a liberal economic program!

In its first two years, moreover, the Marshall Plan established a complex system of bilateral drawing rights among European recipients of Marshall Plan aid. The result of this “Little Marshall Plan” (as it was called) was to subsidize governments with overvalued currencies and large trade deficits and to penalize governments that attempted to maintain discipline in their accounts. Ludwig Erhard, West Germany’s Minister for Economic Affairs from 1949 to 1963, once estimated that Belgium lost four-fifths of its dollar aid in the first years of the Marshall Plan due to these perverse incentives.18

Erhard’s general assessment of the plan is worth recalling, not least because he was so closely and completely involved in the West German Wirtschaftswunder. While making clear his gratitude for American generosity, he also pointed to some unintended consequences of the early Marshall Plan aid:

Countries whose policy was nationalistic, or pursued camouflaged or open inflation, used the Little Marshall Plan simply as a welcome subsidy. Thus the Marshall Plan proper was abused to provide a premium on nationalism rather than to favor a healthy international market economy and international cooperation. . . . The aim was to assist difficult payments positions in order to eliminate them for the future: but in fact the crisis risked being perpetuated rather than eliminated.19

More recent scholarship has affirmed Erhard’s assessment. In recent years scholars have approached the Marshall Plan from widely divergent philosophical perspectives, yet they have been drawn toward a very similar conclusion. According to such reassessments, the ERP’s

19Ibid., p. 102.
contribution to European recovery may have been more complex and less dramatic than is commonly assumed today.20

This is not to say that American aid was inconsequential to Western Europe's economic recovery and subsequent boom. To the contrary: the United States played an important, even decisive, role in these events, although precisely how it did so is not always understood or appreciated today.

Two interventions require special mention. The first was the American security guarantee that was provided to Western Europe initially through the informal Fax Americana of 1945 to 1949, and thereafter through the formal obligations of the North Atlantic Treaty Organization (NATO). America's political and military commitment to the continental regimes instilled them with a quality they would otherwise have manifestly lacked: credibility. That credibility contributed to stability, and it promoted business confidence not only within the localities in question, but on the part of foreign investors as well.

Second, the Marshall Plan gave a belated push to European integration—that is, to economic liberalization. Alongside the founding of NATO came the organization of the European Payments Union (EPU). The EPU laid the basis for currency convertibility among its members (although full convertibility was only to come later). In so doing, it also generated competitive pressures for the reduction of trade barriers and tariffs among its members. In retrospect, the EPU can be seen as having paved the way for the specialization that helped to propel Western Europe's postwar economic advance. But even at the time, contemporary observers counted the EPU as one of the Marshall Plan's most important accomplishments21—no less important, perhaps, in that it helped to undo some of the work that the plan itself had originally financed.


Japan

The U.S. occupation of Japan—"Japan's American interlude," as one scholar has described it—lasted from 1945 until April 1952. Accustomed as we have become to Japanese prosperity, it may be difficult to remember just how hard-pressed the country was during those years. At the end of the U.S. occupation, economic conditions seemed favorable only in comparison to the catastrophic year following the unconditional surrender. In 1951, industrial output was still significantly below its 1937 levels. Foreign trade did not reattain its prewar volumes until the mid-1950s—well after the occupation was concluded. By almost any economic measure, Japan's postwar recovery was in fact slower than Western Europe's, not more rapid.

Between mid-1945 and mid-1950, the United States extended considerable financial assistance to Japan. Under the program of GARIOA (Government and Relief in Occupied Areas), total transfers during that period exceeded $1.8 billion (or roughly $7 billion to $8 billion at today's prices). None of this aid, however, was earmarked for "development," and only a portion of it was allocated to the tasks of reconstruction. As the "R" in GARIOA was meant to indicate, much of this aid went directly to relief, in an effort to prevent widespread starvation through direct handouts or by provision of supplies to make-work industries. On this regimen of relief, recuperation was halting: as late as 1949, the official index of manufacturing activity was at barely half its 1937 level.

Relief-oriented aid was only part of the economy's problem. Allied officials were, for several years, ambivalent about the prospect of a Japanese economic recovery. Their attention was instead concentrated upon imposing a radical political and social transformation upon the archipelago. As one observer commented, "Whatever the political and social merits of these measures, they certainly made no immediate contribution to economic recovery. Most of them actually impeded it. 'Punishment and Reform' is indeed an apt description of the first phase of the American policy."23

Recovery and expansion were facilitated, if not actually led, by a shift in Allied policy toward what Michio Morishima has called the "San

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Francisco regime" (after the site of Japan's 1951 peace treaty with most of its erstwhile enemies). Regional events—including the collapse of the Nationalist government in China and the Communist surprise attack in Korea—had impressed policymakers in Washington with the importance of Japanese recovery.

In itself, the determination that the occupiers would not positively obstruct economic restoration was of course significant. As for interventions encouraging economic growth, the inadvertent played a role alongside the deliberate. The Korean War, for example, was a great windfall for the Japanese economy, insofar as it resulted in a regional trade boom and occasioned major U.S. infusions into the domestic economy. America's subsequent designation of Japan as the principal "forward base" in its Asian security system, for its part, not only affected the intangible quantity of business confidence in the country, but brought very tangible economic benefits as well. In the five years after the outbreak of the Korean War, U.S. "special procurement" expenditures in Japan totaled $4 billion. Other U.S. military activities had a further impact on the domestic economy.

America's less accidental contribution came through what Jerome B. Cohen once called its "sponsorship" of Japan. In his recounting:

After the signing of the peace treaty in 1952, the United States government sponsored Japan's reentry into world trade relationships, concluding reciprocal trade agreements with Japan, securing admission to the General Agreement on Tariffs and Trade, and using its own tariff concessions to other nations to secure favorable treatment for Japan. United States firms concluded a large number of technical assistance contracts with Japanese companies which enabled them to obtain the latest know-how, patents, copyrights, and machinery and equipment, as well as training for their technicians. The U.S. International Cooperation Agency [the precursor to AID] established a Productivity Center in Japan to help Japanese industries become more efficient and competitive.

In short, the United States made it easier for Japan to undertake the outward-looking economic policy that its leaders already clearly wished to pursue.

Any account of the "American interlude" in Japan that neglected the political and social revolutions wrought by the occupiers would be

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26 Ibid., pp. 19-20.
critically incomplete. Indeed, many people in both Japan and the United States would argue that the occupation’s principal accomplishment was to prepare the country for liberal democracy.

The American-written constitution that was presented to a defeated Japanese nation is still in force today. That very aspect of its authorship speaks broadly to the exceptional circumstances under which Japan’s political and social transition away from dictatorship was executed. Two contemporary observers put it well:

The United States, as the occupying power, had practically absolute authority and control in Japan. . . . The United States was uniquely free to determine and expedite its policy. Japan was not divided into zones of occupation. . . . The Far Eastern Commission. . . . in the main deferred to American leadership and supported the United States in the policy it pursued. [American policy in Japan] was the choice of the United States as exclusively as foreign policy can ever be the free choice of one country.27

The extraordinary nature of that situation should require no further emphasis (though one may note, however, that despite America’s nearly complete latitude in reshaping political structures and legal arrangements in Japan, a growing number of Western students of Japan seem to question the degree to which the country today qualifies as an open society or a liberal order.28 The debate about the openness of the modern Japanese order is unlikely to be concluded, much less resolved, any time soon. In itself, however, that debate may remind us of the limits that may be expected of policies to promote democratization—even under the most favorable auspices imaginable.

Korea and Taiwan

Unlike Japan and Western Europe, the Republic of China and Korea received significant amounts of American assistance expressly for the purposes of “development.” Between 1949 and 1961 alone, AID’s predecessor organizations transferred over $1.2 billion to Taiwan and

27 Brown and Opie, p. 352.
28 For example, Chalmers Johnson et al. (eds.), Politics and Productivity: The Real Story of Why Japan Works (New York: Harper & Row, 1989), and Karel van Wolferen, The Enigma of Japanese Power (New York: Knopf, 1989). While these authors do not contest that radical transformations have been exacted, they see in present-day Japanese economics and politics some continuities in arrangements that were developed under the prewar military dictatorship, or earlier. Scholars who dispute their interpretation, one may note, do not always challenge the facts that they adduce. See, for example, Robert A. Scalapino, The Politics of Development: Perspectives on 20th Century Asia (Cambridge: Harvard University Press, 1980), p. 105.
over $2 billion to Korea (sums whose totals would be much higher if adjusted to their purchasing power in today's dollars). Thereafter, a remarkable economic boom ensued—and continued—in both countries. Between the early 1950s and the later 1960s, according to official statistics, real per-capita output increased by a factor of over six in South Korea, and by still more in Taiwan. In their broad outlines, the experiences of these two countries would seem to present the strongest case for the positive potential of "development assistance."

The case looks somewhat different, however, when it is examined more closely. During the period of maximum "development assistance" inflows, for example, South Korea's economic growth was unexceptional. Between 1953–1955 and 1960–1962, by one estimate, the South Korean GNP rose by 4 percent a year;-sup per-capita growth would have been less than 1.5 percent a year by that reckoning. Remembering the potential for postwar recovery that still offered itself to Korea in 1953, the country's economic performance might fairly be described as poor during those years.

The phenomenon of indifferent growth in the face of massive inflows of aid was, inescapably, related to official policies. The Rhee government may have had many virtues, but it created a distorted and politicized economic environment that discouraged savings, investment, and trade, among other things. Students of the Korean economy have even described the Rhee policies as "aid-maximizing," in the sense that the South Korean government seemed willing to imperil its own economy to prove the need for the foreign bequests it wished to obtain.

Rapid economic growth commenced in South Korea in the 1960s, after the Park regime embraced an export-oriented regimen. The factors influencing that decision were diverse; not the least of them was surely Park's coup itself. But U.S. aid also figured in the shift, albeit not in a manner that is widely understood.

In late 1962, American officials discreetly informed their Korean counterparts that U.S. economic aid would be cut back sharply in the coming years, and eventually curtailed. A dispatch in the New York Times several months later captures the flavor of the event:

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The United States has quietly decided to reduce economic assistance to South Korea, a country whose economy is heavily based on such assistance. The decision was taken considerably before the current political struggle between the military regime and civilian leaders. Leading South Korean officials have been told privately to expect reduced aid. For months they declined to believe that Washington meant what it said, but now some of them believe it and, in the words of one American, are in a "dither" about it. Any future government, civilian or military, will find the flow of United States grants thinner and more carefully controlled. Washington has decided it can no longer underwrite all the shortcomings of the South Korean economy.\(^{31}\)

In the years before this unexpected announcement, U.S. economic assistance had accounted for as much as half of the South Korean government's official revenues.

Korean policymakers themselves have had little to say about the connection between the prospect of foreign aid reductions and the decision to pursue export-oriented growth. One study of the period, however, explained it in the following manner:

With the collapse of the Syngman Rhee government in 1960 and the installation of a military government, economic policy clearly shifted from reconstruction and stabilization to a program of rapid industrialization based on exports. The shift of policy reflected the changed circumstances confronting the economy. At the same time, the U.S. government announced that assistance would be terminated in the near future. Consequently, expanding exports seemed the soundest way of replacing the impending loss of foreign exchange, as well as of creating employment in the major urban centers.\(^{32}\)

While South Korea's export-oriented strategy should by no means be seen as inevitable, the decision to reduce, and even terminate, "development assistance" appears to have contributed to the pressures that led to its triumph.

In Taiwan, circumstances were not as extreme, but the patterns were similar. Per capita economic growth in the Republic of China is thought to have been more rapid than in Korea between 1953 and 1962 (roughly 3.8 percent a year), but it accelerated sharply after 1962. Just as in Korea, albeit at a somewhat earlier date, the Taiwanese government had been informed that American economic aid would be shut off, just as in Korea, the government subsequently embraced an outward-looking economic policy.

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\(^{32}\)Mason et al., p. 95.
The impact of aid reductions on Taiwanese economic policy has been carefully recalled by K. T. Li, who, as a minister in the KMT government, was long responsible for framing such policy.

In anticipation of the termination of U.S. aid, serious efforts had been made by the government in 1969 to improve our investment climate. The promotion of exports was begun in earnest at about the same time, with the United States becoming an increasingly large buyer of our products. So, with the phase-out of the U.S. aid program in 1965, the donor-recipient relationship between our two countries was transformed with virtually no interruption to one of business partnership, based principally on trade and investment.33

One should not conclude that American aid was extraneous to the progress of these highly successful economies. Both countries faced very real military threats from communist rivals; the survival of neither Taiwan nor South Korea was a foregone conclusion. The American security commitment to both countries figured incalculably, but importantly, in their development. More than that, American military aid played a major role in their domestic economies. For although this fact is often overlooked, economic or "development" assistance accounted for only a minority of the grants the United States extended to the governments in Taipei and Seoul. Most of the American aid was earmarked for military and security programs.

K. T. Li's reflections on the actual contributions of U.S. aid to his country are worth quoting in this regard:

It is reasonable to assume that without the United States having made the commitment to support a strong Chinese armed forces to protect Taiwan, we could not now write about the successful development of the island. In at least that sense, aid was a necessary condition. Although it is less clear how necessary (economic) aid was after the mid-1950s, my feeling is that it certainly gave us a breathing space for shaping up and carrying out a policy of self-sustaining growth and provided a climate for outward-looking development.34

A parallel reading might be appropriate for Korea as well. For both Korea and Taiwan, America's political and military support preserved the possibility of rapid economic growth. Rapid development itself, however, seems to have been brought about, in part, by the systematic reduction of "development assistance" funding.

EASTERN EUROPE'S CIRCUMSTANCES

Reviewed as a group, the "success stories" of U.S. economic assistance do not seem to offer any immediate or obvious encouragement to the new aid initiatives now being contemplated for Eastern Europe. Few of the components that figured decisively in these earlier successes are likely to be replicable today. Other components are no longer necessary to replicate, since they already exist.

For example, although the several states of Eastern Europe may or may not ultimately choose to join the NATO alliance, they are unlikely to require the sorts of security guarantees and military aid from the U.S. that Western Europe, Japan, Taiwan, and South Korea variously enjoyed. Indeed, the very fact of their newfound independence from Soviet orbit only emphasizes the remoteseness of that contingency. And it is hard to imagine that these countries, long subjugated to a Soviet-style dictatorship, would now voluntarily invite the United States or other governments to exercise temporary but complete mastery over their arrangements to fashion new constitutional or civil orders.

Moreover, the international trade and finance markets so vitally important to earlier U.S. aid "success stories" are already in place; they need no duplication for East European countries to avail themselves of them. As for terminating flows of "development assistance," the United States is apparently no longer capable of conferring this potentially important benefit on recipient economies.

What about conditions in Eastern Europe itself? How might these inform the design of a potentially useful program of "development assistance" for the region? Can the nature of current problems, and opportunities, in these areas give us any insights into the prospective impact of such a program, assuming that it could in fact be formulated and implemented?

Here, a few broad observations must suffice. First and foremost, it may be misleading to think of Eastern Europe as a "region." "Eastern Europe" was defined, and indeed created, by the Soviet occupation that was common to the populations of these territories. With the passing of that episode, many of the differences that preceded the formation of Eastern Europe as a "region" are again more easily distinguished. The populations of the region differ in languages, religions, cultural heritages—even in their alphabets. They also differ in their political and legal traditions. There is no reason to expect that those differences will be erased in the near future, any more than they were under the common experience of occupation.
Second, political developments at the moment vary significantly from one state to the next. In Prague, the current Minister of Finance is an avowed disciple of Milton Friedman, in Romania, by contrast, both polity and personnel mark the continuities between the old regime and the new. As one observer has commented, “The age of uniformity is over.” Naturally, this must be true as well of prospects for political liberalization and economic development.

Third, as one perhaps would expect of a newly liberated area, conditions are still evolving, and retain at least a degree of fluidity. In the months since the “gentle revolution,” for example, Czechoslovakia has officially become the “Czech and Slovak Federated Republic”; the difference is more than a matter of semantics. Perhaps paradoxically, the volatility of the landscape at the moment not only reduces the utility of a detailed focus on current events (such as proposed or pending measures for “policy reform”), but it also limits the ability to generalize about problems and opportunities.

Yet in a sense, the diversity and fluidity of conditions in Eastern Europe today are a boon rather than a hindrance to analysis, for they serve to emphasize the economic and political problems that are most central to the prospects for these populations.

At the moment, two obstacles to economic and political development in the region seem to stand out above all others. Though they affect each country in a somewhat different measure, they are common to them all. Moreover, they are sufficiently serious as constraints that they may indefinitely postpone the reunion of these countries with the rest of Europe, both economically and politically, if they are not relieved. Not surprisingly, both obstacles devolve from the region’s Soviet interlude.

The first, and arguably most important, is the pervasive institutional maladaptation that Soviet rule occasioned. Such maladjustment, unfortunately, goes beyond even the irrational process of central economic planning and the cumbersome, expensive system of socialist enterprise management (though these are also its legacy). For in the exercise of communist power, the socialist rulers of Eastern Europe spent more than four decades destroying the institutional framework for a civil order in these countries. Their war against the civil order was not only understandable, but necessary, for the totalitarian claim upon society is absolute, and any doctrine or arrangement which rec-

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ognizes the realm of the private, or implies the propriety of limited government, must automatically be its enemy.

To some significant degree, Eastern Europe's communists succeeded in their quest to destroy the institutions of a civil order and to replace them with their own. Their accomplishment may have mattered less for its distortion of economic structures than in its perversion of the law. "Socialist legality" came to dominate the rules and thus the workings of everyday life. The phrase, of course, is a contradiction in terms. Devised to ratify the socialist state's completely unrestricted exercise of power, the "norms" of this legal order were necessarily arbitrary, provisional, and subordinated to politics.

Anders Aslund has detailed what he calls the "legal degeneration" that colored the environment in which Eastern Europe's private enterprises struggled to survive. The attack against the legal system, however, was even broader than Aslund's specific critique might be taken to suggest. It was not only the framework of property rights and individual rights that came under assault, but the very rule of law itself. In liquidating the "bourgeois state," Soviet-style communism undermined the foundations of the Rechtsstaat.

The political implications of the demise of the Rechtsstaat should be clear enough. Scarcely less important, though, are its economic implications. Economic historians of such different outlooks as Douglass North and Nathan Rosenberg have argued that the "rise of the Western world"—or the story of "how the West grew rich"—was directly and inextricably linked to the new institutional arrangements it developed. In their accounts, perhaps none of those arrangements was more important than the framework of legal protections for individuals that included the right of enforceable private contracts.

Though this legal and institutional framework emerged from what is widely called the "European tradition," the populations of Eastern Europe have been separated from the tradition for more than four decades. In each of the countries of Eastern Europe today, in fact, the

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majority of the local population has no memory of firsthand exposure to this tradition, to say nothing of personal familiarity with it.

The disrepair of this tradition suggests that the institutional obstacles to Eastern Europe’s development are very much greater than would seem to be implied by today’s intense discussions about, and proposals for, “privatization” of state-owned enterprises. To be sure, disendowing the states of the assets they have taken for themselves, and now claim to own, will surely be an immense task. Over the course of Margaret Thatcher’s eleven-year tenure as Prime Minister, the British government succeeded in transferring something less than 5 percent of the country’s output from the government’s ownership back to private hands; in Eastern Europe, the “privatizations” now contemplated are at least an order of magnitude greater. These are ambitious undertakings. But how much more ambitious appears the task of establishing a permanent, legitimate arrangement for the protection of individual rights and the enforcement of private contracts!

Institutional development is not the only enormous obstacle to development in Eastern Europe. Poland, Romania, Czechoslovakia, Bulgaria, and eastern Germany are also beset by what might be described a crisis of “human capital.” This imprecise but evocative term refers to the ineluctably human factors in the production process that can be purposely augmented—or, alternatively, depleted.

Perhaps the most telling evidence of the decline of “human capital” among the populations of Eastern Europe has been the long-term deterioration of health conditions evidenced in both the USSR and its former satellites there. That deterioration can be described in many ways, but it is represented very clearly in the local patterns of mortality. Between the mid-1960s and the mid-1980s, age-standardized death rates in the USSR and Soviet-occupied Europe actually rose. (No other region of the world reported such a trend, and, in fact, no other industrial countries have ever experienced such a general and long-term decline in public health during peacetime.) By the late 1980s—more recent figures are not yet available—age-standardized death rates in Eastern Europe, which had been similar to those in Western Europe only a generation earlier, were on average about 30

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percent higher. By the late 1980s, Eastern Europe’s lowest death rates (East Germany) were substantially higher than Western Europe’s highest ones (Ireland). Indeed, East European death rates, on the whole, were higher in the late 1980s than those reported for such Latin American societies as Argentina, Chile, and even Mexico.42

One need not posit a tight, mechanistic relationship between levels of health and levels of output to appreciate the significance of these differentials. By its very nature, rising mortality imposes constraints upon the productive capacities of the societies affected. Moreover, because rising mortality trends are so anomalous in the modern era, they suggest the possibility that other, more poorly measured aspects of “human capital” may also have been affected by the etiology as well.

Institutional maladaptation and the decay of the “human capital” (or at the very least, significant components of it) might be all the more formidible impediments to development in Eastern Europe if the problems proved to be closely connected rather than independent of one another. At the moment, there is little in the way of research to suggest that they are indeed organically related. Yet it may be more than sheer coincidence that these two problems should have emerged together under Soviet rule. An environment in which augmentation and preservation of physical capital has proved so problematic, after all, may not be much more auspicious for the preservation of “human capital.”43 If organically linked, ameliorative redress might be all the more difficult; resolving the crisis of “human capital,” for example, might be impossible without first undoing the distortions in the local institutional structure. Even if these problems were entirely independent of one another, it is by no means self-evident that they should be self-correcting simply by virtue of independence from the USSR.

43 Various links between institutional maladaptation and deterioration of human capital in the East European setting may be surmised. Environmental degradation of an appalling nature, for example, appears to have been a direct consequence of communist policies and arrangements; that deterioration may have been sufficiently severe to affect the health of the populations in question. By the same token, the region’s state-owned health systems, which reserved for themselves the right to decide on availability, quantities, and qualities of service for potential patients, may have been incapable or unwilling to respond to the needs evidenced or articulated by the individuals they were in theory to serve. Other, more subtle interactions might also be imagined, including those regarding attitudes, outlook, and motivation on the part of the general populace.
Can American "development assistance" specifically assist in relieving those obstacles to development in Eastern Europe? At the moment, it is very difficult to imagine how it would hope to do so. AID has no comparative advantage in helping to build the foundations of civil order. Nor was it designed for helping to arrest mortality increases in industrial societies, or even for contributing to the preservation and augmentation of human capital in such places. Developing such capabilities, of course, would be beneficial, but the organization would need to start almost from scratch to do so.

What is true of AID's limitations applies more generally to the entire field of "development policy." That policy today is not obviously ready to engage the problems it will face in the post-Soviet world. Modern-day "development economics" has arguably advanced and refined a number of useful analytical tools, but their utility in surveying the terrain of a post-Soviet society is less than immediately apparent.

Under the best of circumstances, a conventionally trained "development economist" may offer helpful advice to the policymaker on how to "get prices right," or achieve balances in the macroeconomy, or devise realistic measures for stabilization. There is merit in such activities. But for societies that were forced to march down the perverted path of Soviet-style socialism, these are hardly central to the problems at hand.44

Overcoming the legacy of the immediate past is likely to require bold and fundamental departures from existing practices and institutional arrangements in each of the countries of Eastern Europe. Respected local voices—Vaclav Klaus in Czechoslovakia, Janos Kornai in Hungary, Jan Winiecki in Poland, Ognian Pishiev in Bulgaria, and many others—recognize as much, and urge immediate and decisive action. By contrast, Western "development assistance" policymakers are in the midst of a debate about the proper "sequencing" of the "reforms" they envision. By some arguments, "privatization" of state

44Nor are "development economists" the only academic specialists who seem to have trouble focusing on the "actually existing problems" of Eastern Europe. "Political scientists" and "political economists" betray many of the same difficulties. One recent comment from such quarters warned that "establishing a property rights regime is by no means equivalent to formulating an appropriate economic policy; even the best microeconomics will not solve macroeconomic problems." Ellen Comiso, "Property Rights, Liberalism, and the Transition From Actually Existing Socialism," Eastern European Politics and Societies, Vol. 5, No. 1 (1991), p. 163. These assertions in themselves are unobjectionable, but their implication seems to be that the shortage of good technocratic advisers is one of the main obstacles to economic liberalization in Eastern Europe. While such a viewpoint may be congenial to many who feel equipped to dispense such advice, it would nonetheless seem to be a serious and indeed bizarre misreading of the current situation in any and all of the countries in question.
enterprises should not be attempted for years. The development of civil codes does not even figure consistently on the agenda.

The World Bank’s recent (1990) recommendations to Poland illustrate the point. The Bank urged the Polish government against undue speed in privatization:

In recognition... of the fact that immediate privatization may not be advisable and/or feasible, the government needs to explore alternative forms of manager/ownership whose key objective would be to introduce greater competition and efficiency in resource use.

It spoke in favor of a similar caution toward capital markets:

It would be important to lay the groundwork for a future capital market... so that... (it) could start functioning when price and other adjustments allow for an improved valuation of capital stock.

It advised against a “one-shot’ approach [in which] all major adjustment measures would be implemented rapidly,” warning that “the costs of the approach need to be carefully considered.” Instead, it advocated as “most promising” a “third, intermediate approach” consisting of a “vigorous stabilization program complemented by an adjustment program phased over two to three years,” and presumably by privatizations at some later date. The report did, however, conclude that its proposed “measures need to be supported by substantial foreign assistance”; indeed, it implies that Poland should be a recipient of various forms of Western financial aid on into the 21st century.45

In defense of such rarefied and even surreal deliberations, one may perhaps observe that they simply are not informed by that which seems obvious to local exponents of fast, radical transformations: the longer the transition to an independent, liberal order is delayed, the lower the ultimate chances of its success.

CONCLUDING REMARKS

The preceding sections may seem to paint a thoroughly bleak picture of the prospect for American, or Western, aid to Eastern Europe. However, the picture is not thoroughly bleak. To the contrary: on at least two counts, there is reason for a certain cautious optimism about the impending aid initiatives.

The first has to do with the leadership in the countries concerned. Initial indications suggest that at least some of the officials who will

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be receiving “development assistance” will be very much wiser and braver than those dispensing it.

The September 1990 Board of Governors meeting for the World Bank and the International Monetary Fund was among the scenes to give a basis for such a hope. In his address to the gathering, Vaclav Klaus of the Czech and Slovak Federated Republic announced, “We know that there have been cases where major financial assistance caused the deceleration, not the acceleration, of the necessary systemic changes that we consider of the utmost importance.”46 Though these were simple words, they were telling—for the highest officials at the Bank and the Fund have been unable to utter them publicly, despite the tens of billions of dollars spent in loans for “policy reform” over the past decade and the obvious results associated with such lending.

The impact of aid depends critically upon the intentions of those who receive it and put it to use. This basic fact raises the possibility that, in at least some East European locales, the consequences of “development assistance” may be more favorable than donors have any right to expect.

The second cause for a cautious optimism is somewhat more delicate. For more than a generation, flows of “development assistance” have been directed exclusively to the brown-eyed populations of Africa, Asia, and Latin America. Today, with the advent of programs for Eastern Europe, some of these flows stand to affect the lives of a contingent with blue eyes and fair hair.

Will the United States, and other Western nations, apply existing “development assistance” policies to European populations with the same equanimity they have in other regions of the globe? Perhaps so. Yet there is at least a chance that the vestiges of barbaric nationalism, which caused so much tragedy in our century, might inadvertently serve the universal good in this situation. If the unhelping consequences of current “assistance” policies are more likely to touch the heart, or reach the ear, when meted out a population more like one’s own, the rethinking of the general practices and premises governing the disbursal of “development assistance” may now be a somewhat greater possibility. And if the populations of Eastern Europe can pre-

vail upon the bonds of seeming kinship to demand reform of an aid process that is unhelpful to them, but not to them alone, their travails may redound to the common benefit of others who struggle unheard beneath recipient governments.
COMMENTS

John Van Oudenaren

In my remarks, I would like to focus on the analogy between current or proposed aid efforts for Eastern Europe and the Marshall Plan, which even a rather skeptical Nick Eberstadt has characterized as a success. In doing so, I would like to broaden the discussion beyond the details of the Plan itself and to look at the general question of West European recovery from World War II.

THE PARALLEL

The Marshall Plan is often invoked by politicians and op-ed writers in discussions of East European recovery, and frequently dismissed as misleading and irrelevant. The argument is made that Western Europe's recovery from wartime devastation is not really comparable to the task facing Eastern Europe, which involves questions of "institutional maladaptation" and the unprecedented problems of transition from socialism to market economy. My own view is that there are certain parallels between the two situations, and that the Marshall Plan analogy, while far from being exact, is closer than is sometimes suggested.

There is a tendency to exaggerate the physical destruction in Europe as a result of World War II. In fact, OECD and UN statistics suggest that in many countries, e.g., the United Kingdom and the neutrals, output and capital stock actually increased during World War II. Before the collapse late in the war, output even in Germany was two-thirds higher than in 1936. On the other hand, the quality of the capital stock was poor. The technological gap with the United States had increased during the war, and much investment in Europe was devoted to import substitution rather than to developing new products and processes. Moreover, much of the capital stock was located in sites that were chosen for strategic rather than economic reasons.1 These factors suggest a certain parallel with Eastern Europe, which emerged from the Cold War with historically high levels of output.

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but whose capital stock is old by world standards and has been developed in accordance with political rather than economic criteria.

To the extent that there was significant physical devastation in Western Europe after World War II, much of it was concentrated in the transport sector, which again suggests a broad parallel with Eastern Europe today, where many of the most severe problems are attributable to underdeveloped or poorly planned and maintained national infrastructures. Other similarities between Eastern Europe today and Western Europe in the late 1940s include the breakdown of regional trade, shortages of raw materials, large external debts, and the loss or nonexistence of external assets.

Moreover, just as there is a tendency in some of the literature to exaggerate the physical destruction of Western Europe in the 1940s, there is a tendency to underestimate the political, cultural, and bureaucratic obstacles to its economic recovery—obstacles that were at least somewhat analogous to those facing Eastern Europe today. Western Europe in 1945 did not face the task of throwing off four decades of Marxist-Leninist economics, but its societies and political systems were by no means conducive to entrepreneurship, innovation, and technological change, as was acknowledged by such different modernizers as Charles de Gaulle and Jean Monnet.2

Other similarities between Western Europe in the 1940s and Eastern Europe today include political uncertainty and the residue of bitterness and distrust directed at those seen as collaborators with the old regime, and the existence of an extremely powerful external model—the United States in the 1940s, the European Community today—that is perhaps not well understood but which stands as an example of wealth and efficiency whose approval is sought and which is seen as worthy of emulation.

**THE MARSHALL PLAN**

Any discussion of the Marshall Plan and its possible relevance for Eastern Europe today must take account not only of contemporary and traditional historical treatments of the Plan, but also of the "revisionist" and "neorevisionist" analyses of the 1980s that are based on extensive use of archival materials.3 Much of this literature re-

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reflects the familiar tendency of historians to go overboard in debunking the conventional wisdom, and some of it appears motivated by a thinly disguised political agenda—namely, the retrospective minimization of the U.S. role in Western Europe's recovery from World War II and its subsequent prosperity and political stability. In addition, this literature seems to overlook two factors that loomed very large in contemporary thinking: the psychological uncertainty engendered by defeat and the perceived Soviet and internal communist menace (and hence the political and psychological need for a decisive American response), and the situation in Germany, where the politics were especially unsettled and where there was far less evidence of economic recovery to prewar levels. Nonetheless, the literature does offer certain insights into the situation in the late 1940s that are perhaps relevant to Eastern Europe's current situation.

Milward (1984) makes the argument that by mid-1947—before Marshall aid began to flow—Western Europe was in the midst of a substantial economic recovery. Except in Germany, there was not the widespread economic disarray that is often suggested. However, a consequence of this recovery was a severe balance-of-payments crisis, caused by continued high demand for capital goods imports from the United States. Accordingly, the main contribution of the Marshall Plan was to allow the capital goods imports and investment boom to continue, and thus lay the groundwork for the sustained boom of 1948–1974.

Milward also argues that "Marshall aid was not in fact important enough to give the United States sufficient leverage to reconstruct Western Europe to its own wishes" (p. 469), and that this was reflected in the pattern of postwar economic cooperation. The United States had emerged from World War II committed to a liberal economic order built around GATT and the Bretton Woods institutions. However, Western Europe's payments crisis, combined with politically motivated resistance from European governments and bureaucracies "destroyed the Bretton Woods agreements almost at birth" (p. 466). What emerged in their place was a second-best alternative based on the European Coal and Steel Community and the European Payments Union, both of which served the cause of economic recovery, but whose establishment represented at least a partial retreat from the liberal principles that the United States championed in 1945.

Whatever the intentions of policymakers on both sides of the Atlantic, their actions produced circumstances conducive to rapid and sustained economic growth. They included high rates of investment in both the public and private sectors. High rates of investment were made possible in part by infusions of capital from the United States, but much investment was self-financed. Self-financing in turn was facilitated by government policies that depressed private consumption. Even though production in many European countries reached prewar levels by 1947, total consumption per capita did not reach prewar levels until 1949 in France, 1952 in Germany, and the early 1950s in some other countries. Population growth, loss of overseas assets, and higher defense spending partly caused the lag between the recovery in production and a full return to prewar levels of consumption, but proinvestment policies contributed to this situation as well.\footnote{UN ECE, p. 62.}

Another feature of Western Europe in the 1940s that emerges from both the traditional and the revisionist literatures was the large and indeed growing role of governments in economic recovery. In many countries, much of industry was nationalized. This was particularly the case in capital-intensive industries, where public control over investment policy was thought desirable. Public investment was high, and national bureaucracies engaged in a large amount of what was called "indicative planning." This model of economic development reached its limits by the early 1970s and contributed to the "European sclerosis" of the 1960s, but it is generally credited with having helped Europe to recover from World War II and to embark on the path toward economic integration.

In addition to high public and private investment, Western European economic recovery benefited from an emerging pattern of intraregional trade and economic cooperation. Early steps in this direction included the internationalization of the Ruhr, French access to the Saar, the formation of the Benelux customs union, and eventually the establishment of the European Coal and Steel Community. These steps were taken partly for political reasons, and their economic effects were sometimes resisted by businesses and national bureaucracies. Nonetheless, they did help to stimulate intra-European trade and lay the groundwork for the formation of the European Economic Community in the 1950s.
EASTERN EUROPE

In discussing the prospects for economic recovery in Eastern Europe, it is useful to examine whether or to what extent the conditions for recovery that applied to Western Europe in the late 1940s are present today, and what role might or might not be played by Marshall Plan-type aid. This is not to say that a replication of the experience of the 1940s is the only path to sustained economic recovery, but it is one possible path, and as such should be taken seriously.

As has been noted, there are important parallels between Eastern Europe’s economic and political circumstances today and those of Western Europe in the 1940s. On balance, however, it appears doubtful that many of the remedies that proved effective in the 1940s can be applied today.

First, in Eastern Europe the conditions for sustained levels of high investment are probably lacking. For political reasons, nearly all governments are interested in ensuring that their people see at least some quick payoffs from the overthrow of communism and the adoption of market systems. Governments thus have very limited latitude for pursuing policies that promote the self-financing of investments. Moreover, unlike in the 1940s, when the model of economic prosperity was across the Atlantic and only a relatively small number of Europeans had the option of emigrating, Eastern Europe is next door to the European Community (EC), and prolonged depressed levels of consumption could set off waves of emigration or social tension.

Second, in Eastern Europe (and to some extent elsewhere as well) the role of government in economic recovery and planning has been discredited. Thus it will be difficult to develop national strategies for investment priorities, such as occurred in the 1940s.

Third, there is little prospect of promoting economic development through intraregional arrangements such as the European Coal and Steel Community or the European Payments Union. All of the countries of the region are focused on getting in the European Community as fast as possible, and they have shown little interest in regional cooperation schemes that they fear may permanently consign them to the periphery of Western Europe. Hungary, Czechoslovakia, and Poland have expressed political solidarity with each other, but in the economic sphere they have tended to compete to be “first in line” for EC admission or to establish preferential economic relations with the Federal Republic of Germany.
Finally, there is some reason to question whether the West Europeans of today will be able to play a role in Eastern Europe analogous to the one the United States played in Western Europe in the 1940s. As has been seen, in the late 1940s and into the 1950s the United States not only provided aid to Western Europe, it also tolerated and even encouraged the formation of intra-European trade and financial arrangements that tended to discriminate against imports from the United States and the entire dollar area. These measures helped to speed Europe's recovery and to turn the dollar deficit of the 1940s into the surpluses of the early 1960s. While the EC is moving to dismantle many of its barriers to imports from Eastern Europe, it is still a long way from practicing positive discrimination against its own exports. Indeed, the very concept is alien to West European thinking, and perhaps nowhere more so than in Germany, where the national discussion of economic issues is dominated by Germany's self-image as Exportweltmeister. Prospects for export-led recovery thus are uncertain, which in turn will help to depress investment in the region.

CONCLUSIONS

For the reasons suggested above, it appears that the Marshall Plan analogy, while not inherently inappropriate for Eastern Europe's current situation, probably cannot provide a guidepost for the economic development of the region. Although the underlying conditions in Western Europe in the 1940s are perhaps more similar to Eastern Europe today than is often suggested, political and economic conditions in the outside world are not conducive to a repeat of the Marshall Plan experience. This suggests that while policymakers can still learn selectively from the 1940s, they will have to look to different models—perhaps East Asia or southern Europe—as well as develop entirely new paths to the economic development of the region.
PART II

PROMOTING PLURALISM AND DEMOCRACY
4. CAN THE UNITED STATES PROMOTE DEMOCRACY?

Graham Allison and Robert Beschel

This essay addresses one principal question: Is it possible for the United States to promote democracy and pluralism? In a larger sense, are there possible actions, programs, and policies to be undertaken—or avoided—that will advance democracy and pluralism?

The law that authorizes U.S. spending for these purposes proposes even more ambitious objectives:

The President should ensure that the assistance provided to Eastern European countries pursuant to this Act is designed—(1) to contribute to the development of democratic institutions and pluralism characterized by: (a) the establishment of fully democratic and representative political systems based on free and fair elections, (b) effective recognition of fundamental liberties and individual freedoms, including freedom of speech, religion, and association, (c) termination of all laws and regulations which impede the operation of a free press and the formation of political parties, (d) creation of an independent judiciary, and (e) establishment of non-partisan military, security, and police forces.

Since this law has been passed by the U.S. Congress and signed by the president and is now being implemented by democratic governments, is this not the answer to our question? Can academicians do more than summarize initiatives on which the U.S. government, pursuant to this act, is now spending funds? If so, on the basis of what suprademocratic authority?

To bring the central question into sharper focus, it is necessary to be explicit about the lenses through which we view the evidence. Operationally the question appears straightforward enough, and the answer obvious. Viewed historically, one observes cycles of enthusiast...
asm and self-confidence about the promotion of democracy. In the upswings, the answer seems clearly yes; on the downside, certainly not. Through the lens of theory, the subject appears much more complicated. The theorists' conventional wisdom sounds a contrary note; their prevailing answer to the question is mostly "no" or "not much."

AN OPERATIONAL PERSPECTIVE

When addressing the issue from an operational perspective, it is difficult to see how any informed observer could have serious doubts about the answer to the question. Is it an accident that the nations occupied by U.S. forces after World War II are now democracies? Consider recent events in Nicaragua. Does anyone want to argue that diplomacy in developing widespread support for democratic ground rules (including making future economic assistance contingent upon compliance), direct support for the opposition parties, and international supervision and observation of the elections were not significant factors in producing both Violeta Chamorro's victory and the Ortega brothers' acquiescence to this result? Who doubts that America's stance, including various specific actions like the 1990 Air Force flyover of Manila, affected the enthusiasm of the Philippine military for a coup to oust a democratically elected president?

In a recent public speech, Secretary of State James Baker stated that the Bush Administration has chosen a new centerpiece for American foreign policy in the era ahead. Its core: "Beyond containment lies democracy . . . our new mission is the promotion and consolidation of democracy." Thus, senior U.S. officials believe not only that it is possible for the United States government to promote democracy, but that the United States has contributed to the renaissance of democracy in Eastern Europe, Latin America, and Asia and that the United States will continue to promote democracy in the future.

AN HISTORICAL PERSPECTIVE

Historians will remind us that such ambitions are less original than they sound. Who, they might ask, first said:

(A) It is a glorious history our God has bestowed upon his chosen people; a history whose keynote was struck by the Liberty Bell; a history heroic with faith in our mission and our future. . . . Shall free institutions broaden their blessed reign as the children of liberty wax in

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Secretary of State James Baker, address before the World Affairs Council, Dallas, Texas, March 30, 1990,
strength, until the empire of our principles is established over the hearts of all mankind?

(B) We shall fight for the things which we have always carried nearest to our hearts—for democracy, for the right of those who submit to authority to have a voice in their own governments, for the rights and liberties of small nations, for a universal dominion of right by such a concert of free peoples as shall bring peace and safety to all nations and make the world itself at last free. To such a task we can dedicate our lives and our fortunes, everything that we are and everything that we have, with the pride of those who know that the day has come when America is privileged to spend her blood and her might for the principles that gave her birth and happiness and peace which she has treasured.

(C) At the present moment in world history nearly every nation must choose between alternative ways of life. . . . One way of life is based upon the will of the majority, and is distinguished by free institutions, representative government, free elections, guarantees of individual liberty, freedom of speech and religion, and freedom from political oppression. . . . I believe that it must be the policy of the United States to support free peoples who are resisting attempted subjugation by armed minorities or by outside pressures.

(D) Our unfulfilled task is to demonstrate to the entire world that man's unsatisfied aspiration for economic progress and social justice can best be achieved by free men working within a framework of democratic institutions. If we can do this in our hemisphere, and for our own people, we may yet realize the prophecy of the great Mexican patriot, Benito Juárez, that "Democracy is the destiny of future humanity."

Answers: Presidents Wilson (B); Truman (C); and Kennedy (D). Quote A is from Senator Albert Beveridge of Indiana (one of the leading proponents of American imperialism at the turn of the century).

Through the historian's lens, one discovers a recurring confidence among advocates in the inevitable progress of democratic expansion. From de Tocqueville's judgment that American democracy was "a providential fact, that it is universal, it is lasting, it constantly eludes all human interference, and all events as well as all men contribute to its progress," to Lord James Bryce's conclusion that this "trend towards democracy now widely visible, is a natural trend, due to a general law of social progress," advocates have often proclaimed the irresistible expansion of democracy.4

Conversely, eras of optimism are followed by periods of pronounced pessimism regarding the future of democratic regimes, institutions, and values. In 1940, when England stood alone and the Battle of Britain was at its height, doubts about democracy’s future were dominant. In the mid-1970s another crisis of confidence in democracy was fashionable. Willy Brandt offered the following assessment:

Western Europe has only 20 or 30 more years of democracy left in it; after that it will slide, engineless and rudderless, under the surrounding sea of dictatorship, and whether the dictatorship comes from a politburo or a junta will not make much difference.⁵

In 1975, a Trilateral Commission study expressed concern about the prospects for democracy in Europe, Japan, and the United States.

Today such pessimism appears odd. Yet, current optimism about the spread of democracy may be equally misplaced. The views of pundits on this subject often display more pronounced swings than the data itself would warrant. Judgments about the viability of democracy appear to be shaped by presumptions and assumptions as much as by systematic analysis.

A number of historical studies are discovering cycles in the development of democracy. One of the most penetrating students of the subject, Samuel Huntington, identifies four phases in the emergence of modern democratic regimes: (1) 1820–1920, when democracy spread from the United States to northern and western Europe, some British dominions, and a few countries in Latin America; (2) 1920–1942, when “democratic trends were snuffed out in Germany, Italy, Austria, Poland, the Baltic states, Spain, Portugal, Greece, Argentina, Brazil, and Japan”; (3) 1945–1950, when democracy expanded as a consequence of U.S. imposition of democracy on West Germany, Austria, Italy, and Japan, combined with decolonization during which many independent countries adopted the political forms of the imperial powers; (4) the early 1950s through the early 1980s, which unlike earlier periods exhibited an oscillation rather than a dominant trend. Huntington notes:

The number of democratic regimes seemed to expand in the 1950s and the early 1960s, to shrink in the mid-late 1960s and early 1970s, and then to expand again in the late 1970s and early 1980s. Overall, however, the net record of change in the state of democracy in the world was not very great.⁶

⁶Huntington, p. 197.
In a manner reminiscent of chartists, (stock market, not English political reformers), Huntington notes a remarkable constancy in the percentage of the world’s population living in free states (as classified by Freedom House). This proportion stood at 32 percent in 1973, after which—except for India’s two years of emergency rule—it never rose above 37 percent and never fell below 35 percent. At the time of his writing in January 1984, the figure stood at 36 percent, exactly where it had been ten years earlier. Huntington’s reading of these cycles contributes to his conclusion that “in the absence of major discontinuities in current trends, a significant increase in the number of democratic regimes in the world is unlikely.”

Even after the democratic revolutions of 1989, the majority of the world’s population still lives in regimes that are either partly or wholly nondemocratic. According to Freedom House’s publication *Freedom in the World: 1989–1990*, the percentage of the world’s population living under democratic rule stood at 38 percent in January 1990. If the newly democratic countries of East/Central Europe are included, it would only raise this total to 41 percent.²

Such figures underestimate the degree to which democratic values and institutions have increased during the past decade. Examined on a regional basis, democracy has made marked advances in Europe, Latin America, and Asia. This expansion has taken place primarily among the wealthier nations. Of the countries the World Bank classifies as “High Income Economies,” 74 percent are democracies. Conversely, 71 percent of the world’s poorest nations have authoritarian or totalitarian forms of government.

**A THEORETICAL PERSPECTIVE**

The shift from history to theory is yet more abrupt. Few subjects have consumed more man-hours of political science (and more trees) than debates about democracy. Arguments and counterarguments go back to the first half of the fifth century B.C., when the idea of direct self-rule emerged in the Athenian city-state. The concept’s most notable critics, Plato and Aristotle, ultimately rejected Athenian democracy in favor of a republicanism that depended upon an essential aristocratic or oligarchic element.

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²Huntington, pp. 221-222.
Most of the dialogue since replays strands of the original debate, with the exception of a major 18th-century development that married the concept of democracy with that of representation. As Robert Dahl points out, "From classical Greece to the 17th century, the possibility that a legislature might properly consist not of the entire body of citizens but of their elected representatives remained mainly outside the theory and practice of democracy or republican government."

In the *Social Contract*, Rousseau rejected representation as inconsistent with the idea of democracy. Yet other thinkers, such as Montesquieu and Locke, had already begun to join the democratic notion of rule by the people with the practice of representation. John Stuart Mill cemented this relationship in the 19th century. Again to quote Dahl, "In his considerations on representative government, John Stuart Mill, stating in a single sentence what to him and his readers could be taken as a self-evident truth, dismissed the conventional wisdom of over two thousand years by rejecting the assumption that self-government necessarily required a unit small enough for the whole body of citizens to assemble."

As representative democracy took root and flowered in the United States, both Americans and sympathetic Europeans, such as de Tocqueville, celebrated this development. After a century of slow but steady progress, Lord Bryce published his classic *Modern Democracies*, projecting the inevitable spread of democracy. Its 1921 publication date coincided with the reversal of the previous century’s trend.

Leading scholars of democracy today include Robert Dahl, Samuel Huntington, Seymour Martin Lipset, and scores of other distinguished academicians. This theoretical literature is: (1) both extensive and impressive; (2) complex, indeed, tending toward even greater complexity than the phenomena it seeks to analyze; (3) suggestive about possible causes, correlates, and conditions that contribute to the emergence and sustenance of democracy; but (4) curiously unsatisfying for someone seeking to answer the action-oriented question that opened this paper. Thus the literature provides little advice for

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10Rousseau did, though, accept representation in his *Government of Poland*.

11Dahl, p. 21.

12In 1787, James Madison claimed that one of the great innovations of the American compared to the traditional conception of republicanism is representation. See Madison, Federalist Paper no. 63 in *The Federalist Papers*, reprint (New York: Mentor, 1961), pp. 382-390.
would-be promoters of democracy other than "cautions" about how little can be done.

We state this impression starkly, recognizing that it is open to the charge of being unfair. Indeed we hope that it will inspire—or provoke—one or more of these scholars to refute it. But to pursue our dominant impression, consider the following, not unrepresentative, quotations from the conclusions of a number of these scholars.

Robert Dahl sums up his masterful and inspiring inquiry of decades in a 1989 publication, *Democracy and its Critics*. He writes: "That no more than a third of the countries in the world are governed by polyarchy [constitutional democracies] should not be surprising. It would be surprising, on the other hand, if the proportion were to change greatly over the next 20 years." To Lenin's question, *Chto Delat?*, Dahl answers: "When I reflect on the conditions favoring polyarchy, I am driven to the conclusion that the capacity of democratic countries to transform non-democratic regimes into stable polyarchies is very limited in the short run." Nonetheless, he concludes: "Yet democratic countries could make a difference in the long run, I think, if they steadily pursued a policy of supporting changes in the direction of democracy and discouraging changes away from it. . . . Democratic countries could aid in the democratization of non-democratic countries by steadily pursuing policies over many years that focus on changes in the underlying conditions that support stable polyarchy."13 Thus to the question of this essay, Dahl offers a qualified "yes." But the book ends without any enumeration of what such actions might be.

Democracy has been a subject of study for Samuel Huntington for more than three decades. His oft-quoted 1984 article, "Will more countries become democratic?" also asks: "What policies should governments, private institutions, and individuals espouse to encourage the spread of democracy?" As noted above, Huntington contends that "the prospects for the extension of democracy to other societies are not great." To Lenin's question, he first insists that only "modest conclusions . . . emerge from this review." He then answers: "The ability of the U.S. to affect the development of democracy elsewhere is limited." Nonetheless, he does identify several ways in which the United States could contribute to democratic development: (1) assisting economic development of poor countries; (2) encouraging developing countries to foster market economies and development of vigorous bourgeois classes; (3) refurbishing the United States' own economic, military,

13Dahl, pp. 311–321. The quotes are from pp. 316 and 317 respectively.
and political power so as to exercise greater influence in world affairs; and (4) developing "a concerted program designed to encourage and to help the elites of countries entering the 'transition zone' to lead their countries in a more democratic direction." But his article contains no specific suggestions about what such a "concerted program" might include.

Since the publication of The Civic Culture by Gabriel Almond and Sidney Verba in 1965, there has been a steady growth of systematic, comparative studies of democracy. Among the most thorough is Transitions from Authoritarian Rule: Prospects for Democracy, a 1986 publication by Guillermo O'Donnell, Philippe Schmitter, and Laurence Whitehead. Their central conclusion relevant to our inquiry merits quotation at length. The authors seek to

capture the extraordinary uncertainty of the transition, with its numerous surprises and difficult dilemmas. . . . If we ever have the temerity to formulate a theory of such processes, it would have to be a chapter in a much larger inquiry into the problem of "underdetermined" social change, of large-scale transformations which occur when there are insufficient structural or behavioral parameters to guide and predict the outcome. Such a theory would include elements of accident and unpredictability, of crucial decisions taken in a hurry with very inadequate information, of actors facing irreconcilable ethical dilemmas and ideological confusions, of dramatic turning points reached and passed without an understanding of their future significance. In it the unexpected and the possible are as important as the usual and the probable. 

The most extensive comparative study, supervised by Larry Diamond, Juan Linz, and Martin Lipset, examines 26 developing countries in Asia, Africa, and Latin America. The overview of this study's findings appears in a 1990 publication, Politics in Developing Countries: Comparing Experiences with Democracy. Three decades earlier, Lipset's Political Man had pursued the search for necessary and perhaps sufficient conditions for democracy, emphasizing the link between economic development and the likelihood that a society is democratic. In one of the more famous propositions from this discussion, Lipset asserts: "The more well-to-do a nation, the greater the

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14 Huntington, pp. 221–222.
chances that it will sustain democracy." The most recent study abandons the concept of "preconditions" and shifts instead to what the authors label "facilitating and obstructing factors" in democratic development. It discusses such factors under ten headings, one of which is "international factors." While the authors "attribute the course of political development and regime change primarily to internal structures and actions," they recognize that internal structures have been "shaped historically by a variety of international factors." On the one hand, they caution that "the potential for democratic influence from the U.S. or other external actors should not be underestimated." In support of the claim, they cite four examples, one positive, one negative, and two mixed: The Kennedy administration's bet on democracy in Venezuela was "an important supporting factor"; the Carter administration's human rights pressure on Argentina failed to force the withdrawal of the military, but nonetheless "saved many victims of indiscriminate repression in the late 1970s and was a factor in the international isolation of the military regime"; in Chile and South Korea, the U.S. role was mixed. On the other hand, they conclude that "at the current time, however, and no doubt in many previous decades, the most important international influences on the prospects for democracy in developing countries appear to be economic ones." The democratic consolidation in Eastern Europe will depend significantly on the "flexibility and vision" of the industrialized countries in dealing with "the critical issues of developing countries' debt and trade." These crude summaries of several examples from the literature of political science do not do justice to these authors, nor to the many others who have addressed this subject. These investigations of "preconditions" or factors that facilitate or obstruct democratic development provide a rich source of clues for present purposes. Nonetheless, we find it puzzling that across the spectrum, students of democracy are almost unanimous in their skepticism or negativism about the U.S. promotion of democracy. A better understanding of this skepticism should be important for the purposes of this conference.

QUESTIONS ABOUT "DEMOCRACY"

Scholarly studies of democracy impart the inescapable complexity that surrounds the simple question with which we began.

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Legitimately, they "complexify" our inquiry by identifying more than a score of fundamental issues and questions, many of which are controversial. Such fundamental queries include:

What do we mean by "democracy"? Is democracy best understood as a phenomenon, or as an intellectual construct? Are there unambiguous criteria for distinguishing democracies from other forms of government?

The most thoughtful recent student of the subject, Robert Dahl, asserts that "democracy becomes essentially an ideal, a political system that is completely or almost completely responsible to all its citizens." Dahl thus finds it useful to create a separate construct—which he labels "polyarchy"—for modern representative democracies with their attendant rights and institutions.19

For our limited purposes here we will essentially follow Joseph Schumpeter's definition of democracy, which, as Diamond et al. note, requires three essential conditions: "Meaningful and extensive competition among individuals and organized groups (especially political parties) for all effective positions of government power, at regular intervals excluding the use of force, a 'highly inclusive' level of political participation in the selection of leaders and policies, at least through regular and fair elections, so that no major (adult) social group is excluded; and a level of civil and political liberties—freedom of expression, freedom of the press, freedom to form and join organizations—sufficient to ensure the integrity of political competition and participation."20

What is so great about democracy? To what "problem" is democracy the "solution"? (Possible competing answers include (1) the form of power sharing among individuals in an institution or state most likely to achieve their common purposes; (2) the form of power sharing among individuals in an institution or state most likely to empower and dignify the members of the institution; (3) the form of power

19Dahl notes a strong association between polyarchy and societies marked by a host of interrelated characteristics: "A relatively high level of income and wealth per capita, a high level of urbanization, rapidly declining or relatively small agricultural population, great occupational diversity, extensive literacy, a comparatively large number of persons that have attended institutions of higher education, an economic order in which production is mainly carried on by relatively autonomous firms whose decisions are strongly oriented toward national and international markets, and a relatively high level of conventional indicators of well being, such as physicians and hospital beds per 1000 persons, life expectancy, infant mortality, percentage of families with various consumer durables, and so on." As the plot thickens, lines between definition, causality, and correlation become even more difficult to draw.

20Diamond, Linz, and Lipset, pp. 6–7.
sharing among individuals in an institution or state most likely to preclude the exercise of arbitrary authority; (4) the worst form of power sharing and government for the purposes above—except for all the others.)

For which kinds of associations among individuals, if not all, is democracy the best (or least worst) solution? For national groups, nation-states, the world? What about business firms, or universities, or think tanks, or even a conference? And if for some of these associations and not others, why?

Why should the United States be interested in “promoting democracy”? Is the principal objective national self-determination, or freedom for individuals, or what? Is our objective primarily for them, or for us? Are there significant international implications of the spread of democracy (for example, Kant’s assertion that democracies are inherently more peaceful than authoritarian states)?

Are there “preconditions” for the establishment and maintenance of democracy, or just correlates or dispositions? Is a market economy a necessary condition for sustainable democracy? (Note: all current democracies have market economies, although not all market economies are democracies.) Is a bourgeois class a necessary condition for democracy, as Charles Lindblom would suggest? Most authors assert that a widespread belief in the legitimacy of democratic institutions is a necessary condition. (For example, Dahl asserts: “The greater the belief within a country of the legitimacy of the institutions of polyarchy, the greater the chances for polyarchy.”) But Huntington questions whether “the development of a pro-democratic political culture has to precede the development of democratic institutions.”21

What about the interaction of politics and economics? When countries develop economically, do they enter what Huntington calls “a zone of transition or choice” about democracy that was previously unavailable to them?22 Is the high correlation between levels of economic development and democracy just a correlation? Is there some level of economic development measured in per-capita income that signals a higher probability of democracy (if so, did it shift in the late 20th century to a level significantly higher than what it had been in the century prior, as Huntington suggests)? Which way do the causal connections run?

21Dahl, pp. 260–262; Huntington, p. 211.
22See Huntington, pp. 199–203, 221.
How does the process of democratization relate to the probability of a stable democracy? Is blood required, as Barrington Moore theorizes? Or is Dahl closer to the mark when he argues that stable democracies "are more likely to result from rather slow evolutionary overthrow of existing hegemonies." Is the stability of democracy more likely in cases in which the expansion of political competition precedes the expansion of participation, or vice versa? Is stable democracy more likely to evolve from stable authoritarian rule, or from regimes that oscillate between despotism and democracy?

Is political democracy a "natural condition of mankind"? That is, is democracy more consistent with fundamental human needs, aspirations, and inclinations than authoritarian, oligarchical, or other forms of government?

These questions are both complex and challenging, and they warrant careful consideration. But we will return at this juncture to the operational question: Is it possible for the United States government and society to promote democracy?

WHERE SCHOLARS FEAR TO TREAD: DO'S AND DON'TS FOR PROMOTING DEMOCRACY

When accepting this assignment, the authors expected to find an agenda of actions for promoting democracy in the literature. We are still looking. But since we have been unable to find someone else's list, we will continue where qualified students of the subject have hesitated to tread.

In an earlier volume on avoiding nuclear war, Hawks, Doves, and Owls, we developed a simplistic format for stating an agenda of actions in the form of specific "do's" and "don'ts" for reducing the risks of nuclear war. Thus, for example, one of ten "principles for avoiding nuclear war" states "Obtain a credible conventional deterrent." Under it, there follow a number of actions to take and to avoid: "DO strengthen NATO and the Rapid Deployment Force to levels in which it would not be necessary to threaten escalation to nuclear use to deter Soviet aggression"; and "DON'T pretend that nuclear weapons deter only nuclear war"—a fiction that was gaining currency in the

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early 1980s when the book was written. Shorn of qualifications and footnotes, this agenda was better received by politicians and officials than by academic colleagues. But in retrospect, for all its limitations, we judge it useful.

Here we attempt to formulate the first draft of an “agenda of actions” for a government and society determined to promote democracy. Assuming the U.S. government were to give high priority to promoting democracy, what could it do? Each “do” or don’t” assumes, of course, an unspecified ceteris paribus clause. In a scholarly paper, each would be subject to many qualifications. Moreover, as is true in any policy arena, specific initiatives may conflict with each other and with other national objectives. Tradeoffs and hard choices are therefore necessary. These principles and injunctions identify guidelines for action. They provide starting presumptions or inclinations that must, at the moment of choice, be balanced against other objectives.

Here we will attempt to organize initiatives for promoting democracy under thirteen principles (see Table 1). Each principle identifies a cluster of factors that U.S. policy (governmental and societal) could promote, the presence of which makes sustainable democracies more probable, the absence of which makes them less so. Such factors cover the spectrum from macro considerations that may appear so obvious as to not arise in general discussion, to micro considerations so particular that they have generally been dismissed.

The first five principles identify initiatives that create an external environment favoring democracy. The second five focus on what might be called the infrastructure of democracy within states. A final three target strategies for democratizing individual nations. Under each principle we group illustrative measures that government or other actors in society might take or avoid. A given action like the transfer of the technological infrastructure of democracy might enhance the prospects for democracy on the one hand, while simultaneously increasing the prospects of chaos that could lead to an authoritarian resurgence on the other. Whether a given action should be taken or avoided in a specific instance depends on situational assessment of the net effect on the prospects of democracy, as well as the tradeoffs between promoting democracy and other objectives.

Readers may disagree not only with the judgment stated here, but also with the selection of actions to be considered. This agenda is far from complete and could be expanded with additional measures at the same level of generality. Greater specificity under each do or don’t could lengthen the list still further. Each principle clearly deserves discussion at far greater length than it will receive here. Our princi-


Table 1  
Principles for Promoting Democracy

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<tr>
<th>External Environment Favorable to Democracy</th>
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<tr>
<td>1. Demonstrate democratic societies' superior performance.</td>
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<td>2. Communicate the facts about the superior performance of democratic societies.</td>
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<td>3. Build an international security order favorable to democracy.</td>
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<td>4. Build an international economic order favorable to democracy.</td>
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<td>5. Build an international political order favorable to democracy.</td>
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<th>Infrastructure of Democracy</th>
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<td>6. Promote the pluralization of society.</td>
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<td>7. Encourage the evolution of a political culture compatible with democracy.</td>
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<td>8. Strengthen democratic institutions.</td>
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<td>9. Assist the development of market economies.</td>
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<td>10. Socialize military and security forces to respect democratic norms and values.</td>
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<tr>
<th>Strategies for Democratizing</th>
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<tr>
<td>11. Nurture and support leaders who are building democracy.</td>
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<tr>
<td>12. Provide sustained advice and assistance about critical choices in transitions to democracy, market economies, and cooperative international relations.</td>
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<tr>
<td>13. Be sure to differentiate between various regions and countries.</td>
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The principal objective is to demonstrate that there are a host of actions that can be taken to promote democracy and to stimulate others to formulate more satisfactory agendas.

Create an External Environment Favoring Democracy

1. Demonstrate democratic societies' superior performance.
   
   - DO make American industrial democracy a "shining city on a hill."
   - DON'T neglect the failures of American society.

The democratic revolution of 1989 in Eastern Europe was more clearly a vote against a Marxist-Leninist system that failed (relative to the competition) than a vote for a democratic market economy.
Consider the likelihood of such developments had Marxist-Leninist systems performed better than Western democracies in providing what people most want: economic well-being, individual freedom, political participation, security, and an interesting life—or even one of these. It is a happy but unappreciated coincidence in this era of democratic expansion that the reasons for preferring political and economic democracies to the alternatives included "all of the above." The rejection of communist-imposed socialism in Eastern Europe was not only a vote against tyranny, but simultaneously (and inseparably) a vote for bananas. People were answering the question put so effectively by Ronald Reagan in the 1980 campaign: whether they were better off than they had been, or could be under a plausible alternative.

- DO make American industrial democracy a "shining city on a hill."

The United States has been the demonstration case for modern democracy. Its role as exemplar and promoter of democracy in the recent era, and the period immediately ahead, is difficult to exaggerate. Consider the alternative: if the United States had not been a democratic society for the last century. Indeed, consider the likely history of post–World War II democracies had the United States not been the leading society—economically, scientifically, technically, and culturally, as well as politically. Or consider the prospects for democracy if American society fails in the future. As the Marxists would have said, "It is no accident" that two-thirds of today's modern democracies served substantial apprenticeships under Britain or the United States.

The domestic agenda of dos and don'ts for making not only American democracy, but all the dimensions of American society, "a shining city on a hill" is a lengthy subject of another paper. It stretches from a sane energy policy including a tax on oil that would make consumers pay its full cost (including the security and environmental premium), to the elimination of the federal deficit, increased incentives for savings, strengthening American economic competitiveness, overhauling of the criminal justice system, restructuring the public school system away from monopolies and toward choice, dampening the demand side of drugs, creating powerful disincentives for children having babies, preventing damage to children, discouraging the glorification of violence, pornography and vulgarity of popular culture, etc.
• DO promote the success of the "commonwealth of industrial democracies."\textsuperscript{25}

Almost as important as the success of American society for the prospect of democracies elsewhere is the demonstration effect of America's allies in the commonwealth of industrial democracies, specifically Europe and Japan. The successful reconstruction of defeated authoritarian regimes in Germany, Japan, and Italy, and the rebuilding of Western Europe into a set of industrial democracies that display the features of the most dynamic and successful societies in the world, reinforce confidence and success throughout the commonwealth. This community of shared values, institutions, and practices thus becomes a model for other societies aspiring to any of these dimensions of success. Again, it is difficult to envision the alternative. But imagine that Germany or Japan had emerged from World War II as a successful economy under a more authoritarian guardianship, for example along the lines of Singapore. The ideological Cold War, between the "free world" on the one hand and communist centralization on the other, bundled together elements such as democracy, market economies, scientific and technological leadership, dynamic culture, and modernism perhaps more tightly than they would otherwise have been. The collapse of the communist contender thus leaves but one cluster of institutions and practices standing. (To add a mischievous editorial aside, it leaves unoccupied space for yet another "third way" ideology that would combine elements of socialism and authoritarianism.)

Again, a lengthy agenda of specific actions for promoting the success of the commonwealth of democracies stretches from sustaining revised security organizations like NATO to creating new arrangements for responsibility and burden sharing that include both "pay and say" as well as strengthening a free-trade system in which our stakes are greater than purely economic. The Final Act of the November 1990 CSCE conference represented a clear vote for such an international democratic order. In this act 34 nations, including the Soviet Union and those in Eastern Europe, pledged their commitment to the ideals of democracy and human rights.

• DON'T neglect the failures of American society.

One of the better cartoons of 1990 begins with a frame that says: "In a stunning victory for democracy, Violeta Chamorro has been elected

president of Nicaragua", it is followed by a second that says: "While in Lithuania voters have thrown out the Communists," proceeds to a third that says: "Uncle Sam continues to take a beating in world trade and Japan says we have only ourselves to blame," and concludes: "And studies show that most American kids don’t know where any of these places are.” The unchallenged number-one society in the world is also number one among developed countries in consumption of drugs (50 percent of the world’s cocaine), crime, infant mortality (higher in the nation’s capital than in Jamaica), adult illiteracy, international debt, unwillingness to save, pornography, and growth of an underclass—among other things. As George Will recently observed, "Nothing in Bangladesh should be as interesting to Americans as the fact that a boy born in Harlem today has a lower life expectancy than the boy born in Bangladesh.”26 The domestic agenda for actions addressing each of these problems and others would take us far afield. But it is not irrelevant to the standing of the American democracy, and thus to the prospects of democracy worldwide.

2. Communicate the facts about the superior performance of democratic societies.

- DO provide leaders of nondemocratic countries with direct experience with the facts of life in democratic societies.
- DON’T accept arguments about the moral or practical equivalence of political systems.

Facts about superior performance are not enough. Such facts must be communicated credibly, particularly to citizens in societies whose governments seek to guard them from such truths. Western experts have generally assumed levels of knowledge and understanding on the part of the public in closed societies that the East European revolutions belied. No one who witnessed the shock and disgust of East Europeans discovering apparently well-known facts about the hospitals, hunting lodges, and hotels of their "privileged class,” or their amazement at the extent of their relative poverty, should miss this point again.

- DO act in confidence that “it is ideas, not vested interests, which are dangerous for good or ill.”

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As Keynes explained:

The ideas of economists and political philosophers, both when they are
right and when they are wrong, are more powerful than is commonly
understood. Indeed the world is ruled by little else. Practical men, who
believed themselves to be quite exempt from any intellectual influences,
are usually the slaves of some defunct economist. Madmen in author-
ity, who hear voices in the air, are distilling their frenzy from some aca-
demic scribbler of a few years back. I am sure that the power of vested
interests is vastly exaggerated compared with the gradual encroach-
ment of ideas.27

Thus: communicate the ideas and ideals reflected in superior perfor-

* DO provide leaders of nondemocratic countries with direct ex-
  perience with the facts of life in democratic societies.

Words are an important form of communication, but direct experience
is even more persuasive. Boris Yeltsin illustrates the point vividly in
his autobiography when he recounts his "shattering" visit to an
American supermarket. He relates, "When I saw those shelves
crammed with hundreds, thousands of cans, cartons, and goods of ev-
every possible sort, for the first time I felt quite frankly sick with de-
spair for the Soviet people. That such a potentially super rich coun-
try as ours has been brought to a state of such poverty! It is terrible
to think of it."28

* DO broadcast the facts of life through publications, radio,
television, and audio and video cassettes to the populations of
nondemocratic countries in their languages, and in terms and
comparisons meaningful to them.

Radio Liberty, Radio Free Europe, Television Marti, the BBC World
Service, CNN, and international comparative statistics produced by
various organizations provide facts that undermine nondemocratic
fictions.

* DO provide more extended, direct experience in democratic
societies for the emerging leadership in nondemocratic coun-
tries, particularly through education.

Again, picking up from where our previous quotation left off about
"the gradual encroachment of ideas," Keynes observes, "For in the

27 John Maynard Keynes, The General Theory of Employment, Interest and Money
28 Boris Yeltsin, Against the Grain, translated by Michael Glenny (New York:
field of economic and political philosophy there are not many that are influenced by new theories after they are twenty-five or thirty years of age. For the limited spaces available in universities, democratic societies should focus on emerging leadership, paying special attention both to the most talented and to the children of the current elites. As the leader of a nondemocratic Asian society once explained about students from his country who came to the Kennedy School at Harvard, he was very pleased with the analytic and managerial skills they acquired, but disturbed that they fell victim so readily to "Western democratic presumptions."

- DO encourage analyses by scholars and governmental officials in democratic and nondemocratic countries of objective indicators of society's performance: per capita GNP, health status including mortality and morbidity, education, housing, food, telephones, automobiles, televisions, VCRs, etc.

- DON'T accept arguments about the moral or practical equivalence of political systems.

- DON'T discourage individuals from nondemocratic societies from visiting other nondemocratic societies for direct experience. CIA fears that African students training in Moscow would be infected with Marxist-Leninist ideas would, we suspect, be found exaggerated when compared to the disillusioning impact of facts.

- DON'T bore others with lectures about democracy's superiority, but don't apologize for democratic values or the (relative) performance of democracies.

3. Build an international security order favorable to democracy.

- DO build upon the alliance of industrial democracies in fashioning a strategy for security in the aftermath of the Cold War.

- DON'T follow the advice of balance-of-power "realists" to be indifferent about the domestic structures of societies.

In the aftermath of World War II, the United States sought to shape a type of international order in which American values and institutions could survive and prosper. While the focus of America's Cold War

29 Keynes, pp. 362–364.
strategy was the containment of Soviet communist expansion, it also called for the reconstruction of geopolitical centers of value as democratic, market-oriented allies. This strategy went beyond a recovery aimed only at restoring a world of balance-of-power politics. It was based on a broader vision of what would be required to create a genuine community of nations, as well as a deeper and more optimistic faith in the responsibility-building characteristics of democratic institutions and procedures. What became an alliance of industrial democracies was founded on a particular concept of international order. There was more than hubris and moralism in American efforts to reconstruct Europe and Japan as democracies. Postwar leaders saw a connection between freedom, democracy, and stability. The preference for market-oriented economies was also not just parochial, for postwar statesmen understood the symbiosis between capitalism and freedom.

This basic strategy has proved successful in providing more than four decades of peace to a European continent on which war was as normal as peace in the prior four centuries. Properly understood, this success should be a source of confidence as the strategy is extended into the post–Cold War era.

War and the threat of war pose a danger to democracies, young and old. Responses to security threats require the centralization of power and encourage authoritarian tendencies, while simultaneously raising the visibility and influence of the military in society. Radical historical counterfactuals stagger our limited imaginations. But if one tries to consider the likely history of democracies in Western Europe over the past four decades in the absence of adequate security arrangements, the interaction between security and the prospects for democracy become clearer. What would the prospects for East European democracies be if German unification had not occurred within the framework of stable security arrangements? Similarly, a withdrawal of the American security blanket in Asia, should it come, would likely lead to security conflicts that would pose substantial risks to emergent democracies in the region.

- DO build upon the alliance of industrial democracies in fashioning a strategy for security in the aftermath of the Cold War.

Substantial revisions in basic alliance relations, such as NATO, the U.S.-Japanese treaty, and others will be necessary. But that process should begin with the recognition that at least for Americans, Europeans, and Japanese, in the words of the beer commercial, “It just doesn’t get any better than this.” These alliances have provided a
longer peace, more sustained economic growth, and greater freedom than any of the parties enjoyed under any earlier arrangement. Alliances such as NATO always had positive goals beyond defending against the Soviet threat. Those goals should be explained and extended. The U.S. government should project a vision of a peaceful international order, starting with the foundation of the alliance of industrial democracies and extending, as Kant originally explained, in successive stages to a “widening pacific union” among the democracies of the world.

- DO organize institutional arrangements to provide for the security of the newly independent nations in East/Central Europe. Weak as it is, the CSCE framework may be the best prospect for protecting current borders, while providing a process for adjudicating peaceful changes.
- DO seek to institutionalize open societies, including the full spectrum of confidence and security building measures (CSBM)s to minimize paranoia and the possibility of a government’s conjuring up imaginary enemies.
- DO “discretely” capitalize on victory in the Cold War to build specific cooperative relations with the Soviet Union. Address specific regional security issues and global issues like the proliferation of atomic, biological, and chemical weapons and missiles in ways that contribute to a more secure environment for democracies.
- DON’T follow the advice of balance-of-power “realists” to be indifferent about the domestic structures of other societies.

4. Build an international economic order favorable to democracy.

- DO continue to build upon, extend, and strengthen the international economic order that has emerged over the past four decades.
- DON’T allow leaders of newly democratic countries to imagine that any viable “third way” exists.

- DO continue to build upon, extend, and strengthen the international economic order that has emerged over the past four decades.

America’s postwar strategy aimed to create an international economic system that would provide stable monetary relations, stimulate investment and trade, reward market-oriented economies, and thus
promote expansion of the U.S. and world economies. The Bretton Woods institutions were an attempt to prevent occurrences such as the Great Depression, which created the conditions under which Hitler came to power. The International Monetary Fund, the World Bank, and the General Agreement on Tariffs and Trade together created the institutional structure of an international economic system that promoted growth in the world economy. The Marshall Plan transferred more than 1 percent of U.S. GNP per year to reconstruct the economies of Western Europe (specifically including the defeated economies) as market-oriented democratic members of a security alliance. Similar support helped rebuild Japan.

The performance record of this international economic system is impressive. It has permitted the most rapid and sustained expansion of the world economy in history. Since 1950, world product has quintupled to more than $20 trillion. The American standard of living has tripled. Growth has been most impressive in the allied, market-oriented, democratic societies, and in related allies. Economic growth and thickening interactions with the industrial democracies continue to create pressures for democratization, as in the case of Korea. While the successful economic performance of a society does not guarantee democracy, failing economic performance almost certainly guarantees a failure of democracy.

- DO welcome new democratic market economies into appropriate status in the major international economic organizations as they meet required prerequisites. Assist them in making the transitions required for MFN status, membership in the IMF, World Bank and GATT, and participation in other institutions.

- DO nurture the free trading system, resist backsliding, and press for the expansion of its realm in the GATT Uruguay round. Provide open markets for exports from newly established democratic countries, especially in the realm of agricultural products.

- DO seek to organize a strategy for major Western financial assistance to Eastern Europe, and to hold out a carrot for equivalent Soviet transitions.

- DO recognize the political as well as economic stakes in the post-Cold War process of realigning responsibility for the maintenance of the International economic system.

- DON'T imagine, or allow leaders of newly democratic countries to imagine, that any viable "third way" exists. It is a
powerful and profound fact of history that all viable democracies have market economies. This is no accident.

- DON'T insist on any single model of a market economy. The United States, United Kingdom, Germany, and Sweden are successful examples of market economies.
- DON'T imagine that the system is self-maintaining. Is a significant subsidy to free riders inherent in such a system?

5. Build an international political order favorable to democracy.

- DO establish democracy, human rights, and individual freedom as norms of civilized societies.
- DON'T impose a foolish consistency that would be a hobgoblin of little minds.

The political strand of America's Cold War strategy emphasized promoting democratic institutions and values, not just by example, but by actively building democratic societies elsewhere. We concentrated on the countries that mattered most to the United States. The bedrock of these political institutions are values, and the strategy sought to build a community based upon shared values. These values, which the Declaration of Independence asserts are universal, include the freedom of individual citizens to order their political, economic, and cultural life and the need for governments that derive their powers from the consent of the governed, secured by regular competitive free elections. From the UN Charter and Declaration on Human Rights to the Helsinki Accords, the insistence upon the rights and freedom of individuals in democracies represents more than a preference. These values are essential ingredients in a commonwealth of industrial democracies that promise peace as well as freedom.

A noteworthy recent accomplishment is the Final Act of the November 1990 CSCE conference. In it, 34 nations affirmed the basic principles of human rights, individual freedoms, and political pluralism. Beyond rhetorical affirmation, they agreed specifically to more operational criteria for assessing behavior consistent with these values. Although still in the preliminary stages, they have established the procedures for assessing the actions addressed in Vienna. The evident violation of these commitments in the Baltics will pose a serious test for these institutional arrangements. The Final Act in appendix A affirms a commitment to (1) principles ("the protection and promo-
tion of human rights and fundamental freedoms”; (2) criteria (“prohibit torture”); and (3) procedure (“invite observers from any other CSCE participating States . . . to observe the course of their national election”).

- DO establish democracy, human rights and individual freedom as norms for what the Soviet leadership now refers to as “civilized societies.”

Explain the significance of human rights, including minority rights, and democratic institutions as essential elements in such societies. Make these norms the standards for acceptability and membership in “civilized society” (as in the current effort to include free democratic elections among the criteria for membership in CSCE).

- DO insist on the performance of societies in meeting these standards.

Multiple monitoring and reporting mechanisms, including independent monitors like Amnesty International and Freedom House as well as official multinational organizations, magnify the message.

- DO encourage advocates of victims whose rights are violated.

Emphasize processes most appropriate to the specific society; for example, using the legal framework and independent judiciary in South Africa.

- DO establish and encourage both regional and international “clubs” of democratic societies.

The European Community has played a critical role in facilitating the transition to democracy in Spain, Portugal, and Greece (and in the next phase, in Turkey and the newly independent nations of Eastern Europe).

- DO reward good behavior and penalize violators.

The interruption of international loans to China after Tiananmen Square spoke more credibly than any words of condemnation.

- DON'T impose a foolish consistency that would be a hobgoblin of little minds.

For example, don’t insist that the Moslem countries of the Persian Gulf make a rapid transition to democracy. And don’t insist upon any single model of democratic governance. The American presidential system is preferable for some purposes. But it is a notable fact that when designing political systems for West Germany and Japan, the United States chose parliamentary systems.
• DON'T imagine an "end of history."

There is a large element of fashion in the current democratic revolutions, and fashions change.

It seems clear that there are scores, even hundreds, of initiatives the U.S. government and society can take, and is taking, to promote democracy. Indeed, the puzzle for us is whether, or why, anyone really disagrees with this conclusion. Before closing with speculation on our fundamental question, we summarize the dos and don'ts under the remaining principles.

**Developing the Infrastructure of Democracy**

6. Promote the pluralization of society.

   • DO recognize that private property, private ownership of farms, housing, goods, and enterprises, is among the most solid guarantees of pluralization. People with economic power have power.

   • DO aid and abet independent groups, voluntary associations, and civil society: independent trade unions, businesses, professional organizations, churches, political parties, etc.

   • DO encourage Western groups to interact and stand in solidarity with their counterparts in newly democratic and nondemocratic societies.

   • DO allow and promote an independent press/media, enabling free dialogue and pluralism on a national scale.

   • DO speed the transfer of the technological infrastructure of pluralism to newly democratic and nondemocratic societies: printing presses, photocopiers, personal computers, FAX machines, satellite dishes, and modern telecommunications systems. (Don't hesitate to revise COCOM lists and procedures to free the transfer of most items, limiting only militarily critical technologies—but not IBM ATs, as the United States recently sought to do.)

7. Encourage the evolution of a political culture compatible with democracy.
• DO encourage the international culture that has emerged with modern telecommunications and travel, and the inclusion of those from political cultures hostile to democracy within that international culture.

• DO provide direct experiences for the leadership of nondemocratic societies (especially their emerging leaders) with democratic societies.

• DO educate the emerging leadership of nondemocratic cultures in democratic societies, with the expectation that individuals so educated will be the agents of change in nondemocratic cultures.

• DO encourage “global village” communication networks, like CNN.

• DON'T be insensitive to, or imperialistic about, other cultures; but (as was noted above) don't accept the notion of a moral equivalence between authoritarianism and democracy.

8. Strengthen democratic institutions.

• DO provide information about and analyses of the strengths and weaknesses of various alternative models of democracy regarding constitutions, legislatures, executive branches, civil services and public administration, relations between politicians and bureaucrats, civil-military relations, independent judiciaries, etc.

• DO provide assistance in conducting and monitoring free elections.

• DO provide assistance for newly emerging independent political parties (but don't teach them the bad habits and tricks of American political consultants).

• DO support the establishment of independent, functioning parliaments in new democracies.

• DO support the formation of independent judiciary systems.

• DO promote the development of democracy at the regional and local level.

• DO channel such assistance through nongovernmental organizations, like the National Endowment for Democracy, as well as private foundations and nongovernmental organizations.
tions. This will limit the U.S. government's vulnerability to charges of imperialism.

9. Assist the development of market economies.

- DO provide help for developing the pillars of a market economy: private property, the rule of law, financial markets, a fiscal system, a banking system and a central bank, macroeconomic stabilization policies, antimonopoly regulations, privatization, etc.

- DO work to assure access to world markets for the goods and services of newly democratized market economies, including the extension of the General System of Preferences (GSP) treatment to agricultural products, Overseas Private Investment Corporation (OPIC) eligibility, Export-Import Bank credits, bilateral investment treaties, special tax credits, etc.

- DO encourage private sector development through devices like the Enterprise Fund, the European Bank for Reconstruction and Development (EBRD), regional development banks, etc.

- DO encourage foreign investment and joint ventures. Demonstration projects like McDonald's in Moscow provide models of firms whose imported cattle and seeds for lettuce and tomatoes are several times more productive than their Soviet equivalents and whose methods for delivering services mesmerize Muscovites.

- DO work actively with newly democratic market economies to establish a framework that will attract the type of international investments that transfer technology and know-how and thus encourage production.

- DO provide concrete economic assistance for decisions and policies that will promote economic growth. The IMF, the World Bank, the EBRD, and analogous international banks are the preferred instruments for such conditional assistance.

10. Socialize military and security forces to respect democratic norms and values.
• DO train the emerging military leadership with American and other Western military forces.

• DO make socialization to respect the norms and values of democracy an explicit part of such extended training programs.

• DO encourage the development of independent, civilian analysis of military issues throughout newly democratic and democratizing countries.

• DO support military-to-military exchanges between democratic and newly democratic and nondemocratic countries, including high-level contacts and visits to military training academies.

Strategies for Democratizing

11. Nurture and support leaders who are building democracy.

• DO recognize that key individuals and their choices make a substantial difference in the transition to and maintenance of democracies. Contrary to prevailing social science theories, social transformation is not all a matter of impersonal forces. We need to support those individuals who strongly favor democratic change.

• DO use carrots and sticks in a calculated manner to the advantage of leaders who are building democracy and to the disadvantage of their opponents.

• DO provide rewards for societies in which the leadership is making progress toward stable democracy, and penalize societies whose leadership is moving in the opposite direction.

12. Provide sustained advice and assistance about critical choices in the transition to democracy, market economies, and cooperative international relations.

• DON'T support flying carpets bearing wise men for a weekend.

• DO encourage relationships between expert groups in democratic societies and those in democratizing or nondemocratic
societies (with special attention to those in positions of political responsibility) for sustained advice and assistance about the lessons of Western experience in democracy, market economies, and international relations.

- DON'T require the leadership in previously closed societies to invent for themselves the "cake of wisdom" of Western experience, from double-entry bookkeeping to the concept of an independent judiciary or electoral system.

- DO seek to stimulate a mirror-image matching sector by sector between leaders of newly emerging democracies and established democracies: parliaments, judiciaries, civil servants, military, law, press, accountants, bankers, etc.—aimed at more effective transfer of the lessons of Western experience and support of key individuals in building democracies in their own societies.

- DO provide education and training, especially short courses, on the best practices in various areas of experience in political and economic democracies.

- DO encourage the development of independent universities and research institutions that can assume this responsibility in a timely fashion.

13. Be sure to differentiate between various regions and countries.

- DO realize the inherent limitations of any "one size fits all" approach to promoting democracy.

Regions and countries differ in their history, culture, traditions, internal politics, values, belief systems, etc. These differences are likely to exert an important influence over the likelihood that they will become democratic.

Many of the major gains and setbacks in recent years occurred by region.³⁰ Between 1973 and 1989, Europe, Latin America, and Asia witnessed a considerable expansion in the number of democratic regimes, whereas Africa lost ground. A better understanding of these geographical differences, including the factors that shape them, should provide useful clues regarding how democratic norms and in-

³⁰See Table 1, Mark Lindenberg and Shantayanan Devarajan, "Strong Economic Medicine: Revising the Mythe about Structural Adjustment, Democracy and Economic Performance in Developing Countries," World Politics, forthcoming.
stitutions can best be promoted and transferred within a particular region or culture.

- **DO** watch for specific “windows of opportunity” in which, due to an unusual intersection of political and historical factors, a given country or region is uniquely open to democratic change.

Southern Europe entered such a period in the mid-1970s after the deaths of Franco and Salazar. Latin America and Eastern Europe are there today. Under these circumstances, external assistance—if conducted in a timely, sensitive, and appropriate fashion—can prove particularly effective. Resulting success stories may then serve as inspiration for other countries in the region.

The notion of “windows of opportunity” applies to various stages of socioeconomic development, forms of government, and high levels of economic development. Although scholars are still working to identify specific “transition points” or clear-cut causality, the causal process that leads from the growth and diffusion of economic power to demands for a similar diffusion of political power is apparent. Thus, promising candidates for democratization at a particular level of industrial development could be identified and encouraged towards greater openness.

**CONCLUDING REMARKS**

In conclusion, it may be useful to restate the central question posed in this paper, summarize our answer, and identify a number of important related questions beyond the scope of this assignment. The conference organizer posed a principal question: Is it possible for the United States to promote democracy? Our point of departure was the conference organizer’s healthy skepticism about the government’s capacity in general. This presumption was reinforced by the scholarly community’s specific skepticism about promoting democracy. Since our analysis of the evidence leads us to quite a different answer, we have stated it provocatively. Not only is it possible for the United States to promote democracy, we believe that the United States has promoted democracy, and is promoting democracy. We have identified 69 specific initiatives, actions the U.S. government can take or refrain from, to promote democracy; we have no doubt that it would be possible to identify at least 69 more.

For the academics in our readership, the more precise form of our argument goes as follows: (i) under condition C, the transition to and consolidation of democracy in specific target countries is more proba-
ble, (2) if the United States takes initiative I, then condition C is more probable; (3) thus, by taking initiative I, the United States can promote democracy.

According to this argument, the initiative (taken by the U.S. government and others) that produced the CSCE Agreement (that establishes democratic elections as the criterion for legitimate governments) promotes democracy. Conversely, if failed U.S. policies should contribute to a worldwide recession and protectionism closing markets to newly democratic countries, their overall economic performance would decline sharply, and with it their prospects for sustaining democracies.

If this limited proposition is accepted, then a number of further related questions arise that this essay has not addressed. Although they are beyond the scope of our assignment for the RAND conference, it may be appropriate nonetheless to state several of these questions and indicate what the analysis here may suggest about possible answers.

(1) Is it possible to identify initiatives the U.S. government could take to establish conditions that are necessary for the establishment of democracy in a particular country, or sufficient to guarantee democracy in that country? On the evidence available, while certain conditions are highly correlated with democracy, none appears strictly to be necessary. No one set of conditions appears to be sufficient to guarantee democracy. The best candidate for a necessary condition would appear to be a market economy. While there exist market economies with nondemocratic governments, there are no societies with democratic governments and nonmarket economies.

(2) If the United States (and other democratic allies) were to adopt a coherent program that included many of the items in our agenda (and others that could be added), would the consolidation of democracy in the newly democratic countries of Eastern Europe and Latin America, and transition to democracy elsewhere, be assured? Certainly not. Transitions to democracy are uncertain in every case. Consolidation is never assured. On the historical record, there is no reason to believe that the transition to or consolidation of democracy is easy, quick, or ever assured. What the record does suggest is that there are initiatives that make more probable conditions that make more probable success for democracies.

(3) Recognizing that it is possible for the United States to promote democracy, how much does it want to do so? Has the promotion of democracy been the primary objective of American foreign policy, or
should it be? Rhetoric aside, promotion of democracy has not been
the primary objective of American foreign policy, is not now, and is
not likely to be. When American policymakers have had to choose be-
tween promoting democracy and containing communism—or per-
ceived this to be their choice—"security" has dominated "values." In
the aftermath of the Cold War, however, we believe that promoting
democracy should become a more important objective. Not the over-
riding objective, but rather a priority objective that should have to
compete with other priority objectives.

If one looks at the record and deduces the "revealed priority," that is,
the amount of money or attention devoted to this objective and the
priority given to it when making tradeoffs, the promotion of democ-
archy has not been, and is not now, a high priority of American foreign
policy. Imagine that it were one-tenth as important as the defense of
Western Europe from Soviet attack or intimidation has been for four
decades of Cold War. We might then consider spending 10 percent of
last year's allocation to NATO to consolidate democracy in Eastern
Europe and encourage its development in the Soviet Union. That
would mean $1.5 billion per year devoted to an agenda that could sig-
nificantly improve the prospects for the development of democracy in
Eastern Europe. The likelihood of an economic blizzard there could
be reduced by initiatives to ease debt burdens and provide direct sup-
port for the development of new enterprises, foreign investment, and
joint ventures; to offer sustained technical assistance and training; to
build infrastructure; and so forth. If the United States were prepared
to invest seriously in this effort, and was able to persuade our
European allies to make equivalent investments, it would be possible
to develop a program that markedly increased the probability of suc-
cess in consolidating democracy in Eastern Europe and encouraging
democracy in the Soviet Union.

Rhetoric aside, how much is U.S. assistance to Eastern Europe today
providing per person? In 1990 U.S. aid amounted to approximately
$4. In comparison, West Germany is investing $4,000 per person per
year for the next decade in the former GDR.

(4) Does the United States have a coherent policy or program for
promoting democracy? No. The agenda outlined here provides a
starting list of headings with illustrative laundry lists under each.
Each strand in the baker's dozen could be woven into a strategy.
While some readers will boggle at the notion of 69 initiatives (with
prospects of more), if one compares such costs with initiatives taken
in pursuit of U.S. objectives in Europe over the past four decades,
these are manageable numbers.
Finally, we come again to the question of why there should be such a gap between our confidence that it is possible to promote democracy and the considered judgment of scholars who have studied the issue most and know best. Typically, prescriptions tend to outrun analysis. Authors seem to feel that having analyzed some empirical relationships, they thereby earn a scholar's equivalent of poetic license to prescribe, with little attention to the practicality of their prescriptions. (Indeed, as one of us wrote two decades ago, most policy analysis leaves out a "missing chapter" that marries proposed prescriptions to existing practices and institutions. That chapter is notably missing from this memo as well.)

Why then is there such an understatement of scholarly prescriptions about the promotion of democracy? Others may be able to shed light on this puzzle. Our reflections identify several considerations. First, prescription has not been the purpose or focus of most social scientists studying democracy. Their purpose was to define and analyze and, where possible, to identify correlations of causal significance—not to prescribe. Second, respect for democratic values appears to reinforce reserve about external manipulation and desire to avoid undue interference in the internal affairs of other states. Third, one senses some hangover from unfortunate experiences in the past, whether from enthusiastic for the Alliance for Progress, or for Woodrow Wilson's aspirations, or perhaps even Vietnam. Observers like us, coming fresh to the literature, sense almost a bad conscience or feeling of guilt about the American record. Perhaps many agree with Hans Morgenthau's remarkable proposition: "With unflagging consistency, we [the United States] have since the end of the second World War intervened on behalf of conservative and fascist repression against revolutionary and radical reform. In an age when societies are in a revolutionary or pre-revolutionary stage, we have become the foremost counter-revolutionary status quo power on earth. Such a policy can only lead to moral and political disaster."\(^{31}\) We find Morgenthau's statement to be both inaccurate and dated.

A final factor contributing to scholarly reticence about prescription could be an appreciation for the fact that no identifiable set of conditions is sufficient to guarantee a sustainable democracy. In a world in which many nations are fraught with ethnic, racial, regional, religious, and historical conflicts, and in which various subcultures and belief systems exist that are hostile to democratic values, hubris

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about our ability to export or impose democracy is certain to produce disappointing failures. Yet, for those less captured by the search for sufficiency, initiatives that increase the probability that regimes will become democratic are sufficient to justify the continued effort to promote democracy.
5. HELPING EASTERN EUROPE: THOUGHTS, SUGGESTIONS, AND SOME MILD OBSESSIONS

James F. Brown

"From each according to his ability, to each according to his need." It still has a sort of relevance as Eastern Europe contemplates not the victory of communism but its disastrous legacy. Now it pertains not to millenarian fulfillment but to the West's role in picking up the pieces of failure. Communism's most famous slogan now becomes a rule of thumb for a capitalist salvage operation.

What the liberated nations of Eastern Europe want—and what the West wants for them—is the civil society, a comprehensive and secure democracy. This applies as much to southeastern Europe as to Eastern and Central Europe, as much to Moscow's old "Southern Tier" as to its "Northern Tier." This is worth stressing, lest the West make the momentous mistake of writing off "the Balkans" as both irredeemable and irrelevant. True, Poland, Czechoslovakia, Hungary, and Slovenia look set for political progress, while Bulgaria, Romania, Albania, and the southern parts of what is now Yugoslavia seem polarized politically and caught in a morass of ethnic divisiveness. But the difference between the two regions is relative, not basic; chronological, not chronic. The Byzantine/Ottoman legacy has indeed been retardative, but it is worth remembering that a half-century ago the East-Central European states were plagued by difficulties similar to those prevailing further south; they handled their ethnic problems with a savagery unheard of in the Balkans. (Keep in mind, too, Western Europe's growing racial problems.) Furthermore, the severity of the problems of countries like Bulgaria and especially Romania is due not only to past history but to more recent communist oppression. In both these countries, communist rule came close to being totalitarian. Further north, in Poland and Hungary for example, it was authoritarian. That accounts for much of the difference today. Take Poland and Romania between the two world wars; there was not much difference between the two. But Ceausescu changed all that. Even under communism, Poland and Hungary could retain or develop practices and institutions that smacked of the civil society and could be carried over into the democratic system. Romania and Bulgaria could not.

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THE DECISIVE ECONOMIC BASE

Spain is the Western country whose recent experience is considered the most relevant to postcommunist Eastern Europe. Poland, in particular, is often paired and compared with Spain. The rapid and relatively painless progress of Spain from authoritarianism to democratic constitutionalism is seen as a more realistic example than the long-established democracies of Western Europe and North America.

But whatever political relevance Spain may have is more than neutralized by the economic difference. In latter-day Franco Spain the market was in operation, was institutionalized, and was working tolerably well. Private property was widespread and protected by law. Spain, therefore, had the necessary economic foundation on which Franco’s successors could develop democratic institutions. No East European country has had necessary economic basis—not Czechoslovakia, sound by Comecon standards but pitiful by West European criteria, and not Hungary, despite a quarter-century of sometimes meaningful socialist economic reform.

Without a viable economic base, therefore, no political progress can be secure. This, then, must be the priority target—exclusively so if necessary—for postcommunist Eastern Europe. Western aid should be single-mindedly directed at achieving it. “Pluralism,” “competitive politics,” “checks and balances,” and the like must wait. This need in no way detracts from the longer-term importance of the political and constitutional institutions and procedures. They are, after all, the essence of civil society. But at present they are subsidiary, almost marginal.

In fact, the premature introduction of competitive, pluralist politics in Eastern Europe could jeopardize the entire prospect of civil society. It would delay, dilute, even destroy meaningful economic reform by turning it into a political issue easily manipulated by the self-serving and the demagogic. Effective economic reforms need a democratic consensus cushioning them against the social disruptions they must inevitably produce. It is on this account that the prospects for Eastern Europe look less favorable now than they did immediately following the collapse of communist rule. At the beginning of 1990, Poland seemed to have the two ingredients essential for success: “shock therapy” economic reform and political consensus. If the Poles could make it, others might follow. If the Poles couldn’t make it, others would have little chance. But the collapse of the Polish political consensus in 1990 changed all that. After having been largely instrumental in breaking the Polish consensus, Walesa is now trying to
create a new one. It will be difficult. The penalty for failure could be serious for Poland.

THE POLITICAL TREND

Accepting, then, that economics are paramount and all-pervasive until a minimum acceptable level is reached, what are the dos and don'ts of other aspects of the West's relations with the region?

First, two don'ts—two widespread misconceptions that need dispelling. One confuses democracy's material infrastructure with its essence, identifies the civil society with its logistics. This misconception is found in both Eastern Europe and the West. A decent telephone system and the whole panoply of scientific gadgetry that has transformed the West are now seen, not as a means to an end in Eastern Europe, but as the end itself. Technik macht frei! Nearly, but not quite.

The second misconception goes to the opposite pole: pessimistic, even fatalistic, and sometimes—consciously or unconsciously—racist. The East European nations, the argument goes (the Czechs are usually excepted here) are not yet “ready” (and might never be) for democracy at home and genuine international cooperation. The southeast Europeans, especially, are the victims of this prejudice; for some Westerners they are only marginally better equipped than the Arabs for civilized statehood. Many Westerners, however triumphant (or triumphalist) over the international eclipse of communism, still somehow regret Pax Sovietica in Eastern Europe. Some looked forward to Pax Germanica taking its place, saving the East Europeans from their worst enemy: themselves. But by the middle of 1991, the prospect of Pax Germanica looked far off and forlorn.

Of these two misconceptions, the first is obviously the less harmful. But if not corrected, or modified, it could lead to serious disillusionment for those harboring it and might eventually put them on the same positions as the “Asia begins at the Landstrasse” brigade. Failing to realize that technology was supportive, not salvational, they could explain Eastern Europe's continuing—perhaps mounting—difficulties by the limitations not of the technology, but of the East Europeans themselves. But this technological neurosis could have another, equally catastrophic, consequence. It could become an excuse (conscious or unconscious) for not giving Eastern Europe the kind of comprehensive economic assistance that the building of democracy there really requires. There are already signs that it might be becoming this. In short, keep Pax Americana in its place.
The second misconception is not only pernicious but could result in an even more comprehensive disaster. It would condemn the East Europeans to a marchland existence with wider ramifications. The resulting desperation and destabilization would spill over in both easterly and westerly directions. It would further disrupt what are now the western parts of the Soviet Union. It would also cause tremors in Western Europe. The new Germany, struggling to stabilize its unity and to find a role for itself in Europe, would be faced with yet another difficulty it did not need. Those loose ends of history that were always present, but harmless, in the old Bundesrepublik could be dangerous in reunited Germany.

"CRAFTING" DEMOCRACY

But while this second misconception is rightly condemned, the question of how soon and how successfully viable democracies, even given the right economic conditions, can develop in postcommunist Eastern Europe remains a worrying one, even for Western well-wishers. In the West, democracies and democratic attitudes have grown organically and over a long period (although democratic attitudes are still often conspicuous by their absence). Must the task be as long and Sisyphean in the East?

The answer is that it need not. Both democratic structures and a degree of democratic practice can be crafted—imperfectly but passably, provided the economic conditions are right. Giuseppe DiPalma, writing about the possibilities for democracy in both Southern and Eastern Europe,1 argues strongly that if the necessary political and legal framework is established, progress toward democracy can indeed be made, however slowly and unevenly.

DiPalma makes the following points:

- Genuine democrats, pace the organicists, need not precede democracy.
- The lack of easy familiarity with the workings of democratic rules and institutions need not be an incapacitating hindrance.
- Former communist incumbents (one need not inquire too deeply into their motives) can change their habits. They may not move readily toward democracy, but they "may back into it."

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As a society inches toward democracy, a "bandwagon" effect might be created. Apart from anything else, this would make the danger of a communist "backlash" all the more remote.

DiPalma’s arguments are worth noting, especially by condescending Westerners. He tends, though, to underestimate two things: (1) the understandable vengefulness of society against the former communist incumbents, and (2) the dangers to democracy of economic failure. As long as economic conditions remain “precarious,” this underestimation is probably justified. But if they were to become disastrous, then attempts to forge democracy could give way to the acceptance of populist, authoritarian rule. There is a real danger of this in some countries—not just Romania, but Hungary, Bulgaria, and Poland. This would negate both internal freedoms and external peace.

Once again, therefore, the primacy of economics is emphasized, and also the importance of sufficient, judiciously applied, Western economic help.

WHAT IS TO BE DONE?

Recommendations can easily degenerate into laundry lists. No such list will be attempted here, rather a few general remarks, ending with suggestions about the kind of assistance on which the United States is uniquely well equipped to concentrate.

First, though, another warning—this time against underestimating the East Europeans and overestimating ourselves. In many subjects, the East Europeans need little or no teaching—just the tools to do the job or to enable them to bring their talents fully into play.

Take journalism, for example. Communism, by definition, depressed journalistic integrity and standards. But in Poland, Hungary, and Czechoslovakia there are many journalists every bit as talented and professional as their Western colleagues. Even before the fall of communism there was also much good journalism: in Poland, both before and during martial law, in Kadar’s Hungary, and in the Prague Spring. A bit less Western condescension and a bit more knowledge might be in order here. (East European journalism will not benefit much from certain types of exposure to the West, as paladins like Murdoch, Maxwell, and Axel Springer descend in search of easy pickings.)

There are two areas, though, in which Western help is desperately needed. One—the environment—has often been mentioned. But help here is much more crucial than most people in the West realize.
Unless something is done very soon to slow, halt, and reverse the slide in many parts of Eastern Europe toward ecological disaster, then all the economic, political, and logistic help that might be contemplated will become irrelevant. The East European environmental disaster has already gone beyond being a question of the quality of life. It is now a question of life itself.

Almost as urgent as environmental help, but much less discussed, is help in the sphere of psychology and psychiatry. Many East Europeans—often those the least aware of them—are afflicted with psychological disorders, different in kind and degree. It is not just the “pollution of the mind” to which Vaclav Havel and others have referred—the effects of 40 years of doublespeak and the rest—or the effects of living for decades in a communist barracks, no matter how lax the regulations in some of them were. It is also the effects of crowded living conditions, an antiwork ethic, daily frustration with an inefficient, brutalized, or helpless bureaucracy, shopping queues, etc. (With so much time necessarily wasted in the past, how will many East Europeans learn how to spend their time in the future?) Even worse, for many there is the impact of living with the guilt of having cooperated with the communist regimes or—worst of all—with the security apparatuses in some way or other. There is a whole range of problems here needing expert, sympathetic, and patient help. It is obviously beyond the capacities of the East Europeans themselves. The answer, of course, is not an invasion by budding young American Freudians, but a carefully thought-out campaign of assistance, primarily involving the training of local staff.

Finally, there is a field in which the United States can help Eastern Europe and help itself. American prestige is far higher in Eastern Europe today than anywhere else in the world. This can be exploited for the benefit of both parties. Eastern Europe wants a strong American presence, and America needs a strong presence in Eastern Europe. What kind of presence is possible? A military presence seems excluded. An economic presence is necessary as an earnest of American seriousness, but it will never compare with that of Europe, in general, and Germany, in particular.

But where the United States can sweep the board is in its cultural influence, and from this cultural influence will seep political influence. Culture here is by no means confined to “high” culture, but is used in the broadest possible sense. There is a receptiveness to American culture (and subcultures and countercultures), particularly on the part of younger East Europeans, far greater than to any other Western culture. This must be imaginatively and constructively ex-
ploited by both government and private institutions. How? Three means are worth considering:

- Educational exchanges at every level.

- A beefed-up USIA role, particularly through cultural missions and the more extended use of institutions like the America House. (Such types of cultural activity are all the more necessary so as to complement, and counter, the impact of the waves of American commercial culture already flooding the region.) Every East European city of any size should have its America House. (They have been a huge success in West Germany for so many years.) They will have to compete with the Goethe-institutes, the Maisons françaises, and the British Council, but given the receptive climate, they should see them off without much trouble, provided they are well funded and the whole program is well led.

- Refurbishing and redesigning, but by all means continuing, Radio Free Europe (RFE). In RFE, the United States has a powerful and successful political and cultural instrument already in place, enjoying support, respect, and even affection in Eastern Europe. It could now become (in a way the Voice of America never could) the voice of Atlanticism in Europe, both a symbol and an assurance of America's commitment to Eastern Europe and to its place in the world's mainstream. Conversely, to dismantle RFE would be a signal to East Europeans of America's lack of interest in them, now that communism has been defeated there. If RFE were disbanded, some of the enthusiasm for America would change to bewilderment.

These are just three ways of maintaining and bolstering the American presence in Eastern Europe. There are more. All should be used so as not to waste an opportunity that rarely comes in history—and is never repeated.
6. AID TO EASTERN EUROPE:
THE SOUTHERN TIER

Alex Alexiev

The spectacular collapse of communism in Eastern Europe largely obviated the question "Why help Eastern Europe?" for the West and replaced it with the more urgent "How to help Eastern Europe?" That Eastern Europe does need help is taken for granted, as is generally the belief that the direction in which the region is moving is entirely congenial to fundamental Western interests, to say nothing of those of local folk, trampled as they were under the heavy foot of totalitarianism for some five decades. The inherent virtues of democracy and free markets quite apart, the current tide sweeping the eastern part of the continent is already overcoming the division of Europe that was the main cause of the intractable East-West conflict.

It is perhaps worthwhile to remind ourselves here just how momentous this tide has been, by remembering that until very recently learned experts, arms control advocates, and even former secretaries of state argued strenuously that neither the reunification of Germany nor the disintegration of the Soviet empire was in the best interest of the United States. It is worthwhile to remind ourselves of this because a new bevy of naysayers is already lamenting assorted real and imagined East European ills and conjuring up dark visions of economic failure and social strife, as if longing for the "stability" of yesteryear. I am far from being inclined to gloss over the serious problems that Eastern Europe, particularly its southeastern part, is facing in its march to a better future. Still, it needs to be said again that the pain awaiting Eastern Europe, traumatic though it may be at times, is, to paraphrase the Chinese proverb, the intense but sweet pain of being born and not the prolonged agony of dying.

It is because of this that the West must and will be involved in helping to alleviate the birth pains of the new Eastern Europe, knowing in advance that they cannot be avoided. Yet, to pursue this theological analogy further, one should not forget that the ultimate objective is not to avoid pain but to deliver a healthy baby and that, though the midwife can help, most of the work must be done by the patient.

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If it is a foregone conclusion that aid will be given, then the question of what, how much, and how to give it becomes an important one. For the history of Western developmental aid, but for a few exceptions, is one full of noble intentions and indifferent results or worse.

THE POLITICAL SETTING

I have chosen to focus my remarks on the southern tier of Eastern Europe. While the inexorable trend to democracy affects the entire region, there are significant differences in the nature and pace of the process in the southeastern—compared to the central—part of Eastern Europe that warrant a separate examination. Though this fact is often recognized in the West, its implications for aid policies are not infrequently neglected.

Less than a year after the beginning of the upheaval that marked the end of the old regimes, Eastern Europe split into two distinct groups, each marching to a different drummer, albeit in the same general direction. The GDR, Poland, Hungary, and Czechoslovakia seem to have already embarked firmly on the road to pluralistic democracy and free enterprise. The political structures of the totalitarian system there have largely been destroyed, and the crucial tasks at hand now are the consolidation of the still fragile democratic order and the daunting challenge of transforming the ossified structures of the command economy.

To these four countries I would also add Croatia and Slovenia. Although they still live in a very rough and potentially violent neighborhood, the processes taking place in the two Yugoslav republics exhibit remarkable similarity with the above four. In both Slovenia and Croatia, the erstwhile communist establishments have been decisively defeated in free elections, and a consensus exists that there is no alternative to capitalism and integration with the West.

A much different picture obtains to the southeast, where Romania, Bulgaria, and Serbia form what, for lack of a better term, I would call the Byzantine faction. This term is intended primarily to convey the extent to which history and culture continue to be oppressively relevant there, rather than to imply any commonality of interest among these age-old adversaries. The anticomunist revolutions in Romania and Bulgaria had a manipulated, staged character (despite large-scale violence in the Romanian case) and resulted in outcomes considerably short of a genuine political catharsis. As a result, the political structures of the old regime have remained largely intact, if shaken, as have the internal security apparatus and the communist-
dominated military. Though reform-oriented (some would say warmed-over) communists/socialists preside on top, the conservative party nomenklatura, both in the administrative sector and in the economy, is still very much in control below the top, and it remains a most formidable obstacle to any attempt to introduce genuine reform.

Thus, despite the holding of free, if hardly fair, elections, democratic institutions have yet to take firm root, and economic reform is still in its infancy. Against the background of a rapidly collapsing economy and a mounting popular perception of having been cheated again, this situation is becoming dangerously volatile and may be turning explosive.

Yet another factor that seriously clouds the prospects for rapid progress in southeastern Europe is the pernicious influence of rising nationalism and ethnic strife. Most of the present conflicts have long historical antecedents, but this should not obscure the fact that their renewed acuteness is to a large degree part of the bitter legacy of communism. Brutal campaigns against ethnic minorities by the Zhivkov and Ceausescu regimes have left open wounds and bitterness in the body politic that may take many years to overcome. Worse still, there is considerable evidence that powerful entrenched remnants of the old order are still bent on stirring chauvinism and ethnic conflict for their purposes. The extreme nationalist organizations Vatra Romaneasca in Romania and the Committee for Defense of National Rights in Bulgaria, for instance, are both linked to the old security organs and hard-line elements in the present ruling parties. The situation is perhaps even more dangerous in Serbia, where party boss Miloshevic has made Great Serbian chauvinism and a jingoistic anti-Albanian policy the cornerstone of his effort to preserve the communist party in power. This policy has already brought Yugoslavia to the brink of disintegration and will almost certainly push it into the abyss of violence and civil war if it continues. It is very disturbing, in this respect, to register the remarkable equanimity with which the West observed the unprecedented and wholesale abuse of the human and political rights of the Albanians in Kosovo.

If the foregoing analysis is correct, it would follow that conditions in the southern tier are far from ideal for a successful aid program from the West. It is clear, for instance, that few of the requisite political preconditions exist for the successful application of a large economic aid package, especially of the government-to-government type. Nor should one entertain the illusion that outsiders could dramatically influence the political dynamics of the place. Let me hasten to add that there are things that could and should be done. The neocommu-
nist regimes still in power are desperately trying to cling to it, but
their options are limited by the new realities in Eastern Europe and
the world and by the ironic fact that they find themselves increas-
ingly dependent on the West. Beyond that, there is little doubt that
communism can no more be reformed in southeastern Europe than
elsewhere, which means that it is only a matter of time, and not a
long time at that, before it too succumbs to history. The objective of
Western aid thus should be to try to smooth over this immediate
transition period and prepare the ground for the next stage of genuine
democratization. And, as with all aid, one should always keep in
mind the Hippocratic tenet: Do no harm!

THE POLITICAL DIMENSION OF AID

The objectives of assistance in the political sphere are straightforward
and simple, though far from easy to achieve. They include reinforcing
and speeding up the democratic process, building up democratic par-
ties and institutions, and assisting in the development and consolida-
tion of free and independent media, among others. There are a num-
ber of specific small-scale training programs along these lines that
could be very effective, alongside technical assistance, equipment, and
newsprint. A word of caution is warranted here about longer-term
educational programs. Sending large numbers of students to the
United States, for instance, may be a good idea in the future, but at
present it makes little sense given scarce resources and the better
than even chance that most of them would not want to return home.

In a similar vein, better screening appears to be needed for shorter-
term academic and professional training programs. I was told by a
distinguished professor at Sofia State University, for instance, that
virtually every recipient of a Fulbright or International Research and
Exchanges Board grant to the United States in the past ten years has
been a member of the party or academic nomenklatura. "They con-
sider it a party perk," he said. I have made similar observations even
with respect to people selected by the USIA.

It is important for governments providing aid to speak out forcefully
about nondemocratic tendencies and abuses of human rights that
continue to take place. Speaking out in defense of universal prin-
ciples is not interference in internal affairs and should not be
shied away from. This is not always practiced. For example, the
outrageous conduct of the Iliescu regime in recruiting miner mobs for
the bloody suppression of demonstrations was roundly condemned,
but less glaring abuses—such as the recent removal of local freely
elected officials—have passed unnoticed. The Bulgarian regime,
despite pious protestations of democratic beliefs, still refuses to dismantle the feared State Security organs, a fact that for most Bulgarians means one thing—the process could still be reversed.

It is also essential for Western policies not to legitimize or give the impression of legitimizing regimes that are not perceived as legitimate by their own people. Unfortunately, mistakes in this area still seem to be the rule rather than the exception.

Two other areas should be given close attention in the political realm: policies in the ethnic relations field and the depoliticization of the military. Specific aid policies could be tied to improvement of a regime’s record in the ethnic sphere, while other cultural and economic programs could be designed specifically to assist ethnic minorities. Depoliticization of the military is, of course, a key precondition to the establishment of a democratic system as well as a guarantee against its subversion. Western experts could be recruited either individually, for instance under the auspices of the USIA American Participant Abroad program, or in a group to conduct seminars on the subject. RAND has recently conducted several such seminars in Eastern Europe with considerable success.

THE ECONOMIC DIMENSION

Since I do not possess the specialized knowledge it takes to make an intelligent argument on specific programs, I will limit my remarks to some commonsense propositions.

First, it must be stated clearly to the East Europeans, and indeed to ourselves, that Western economic aid cannot be a panacea for their problems under the best of circumstances. It has been estimated that it would cost some $500 billion to bring the GDR to West German economic standards. As a way of comparison of what may actually be expected, in 1989 total Western investment amounted to some $2 billion. So the large-scale resources some East Europeans seem to fantasize about are simply not available. Even if they were, under the conditions prevailing in southeastern Europe, and in fact throughout Eastern Europe, any large aid is likely to be wasted or stolen by corrupt bureaucracies. Worse still, it may come to be expected and breed the pernicious dependency on Western largesse that has nearly destroyed Africa. Perhaps we need to tell the East Europeans that sometimes one does need to bite the hand that feeds him so it will let him feed himself.

No loans or credits should therefore be given before creating the proper market structures. Even after that, economic aid ought to be
tied to specific projects and tightly supervised. This, of course, applies only to government or government-guaranteed money. Private investors should be free to take their chances.

There may be, however, a need for humanitarian aid fairly soon, as the countries under discussion hit economic bottom and hunger becomes a problem. This is not an idle speculation. The possibility of famine has been openly acknowledged by the Bulgarian regime, and the situation is no better in Romania. This at the end of the 20th century in Europe! It boggles the mind.

At the lower level, it is possible and desirable to render technical assistance to budding entrepreneurs and private farmers as well as to larger private institutions now beginning to sprout. Courses in basic management, accounting, inventory control, and even the most basic precepts of private enterprise could provide considerable payoffs in a system where people have been taught for decades that there is, for instance, a major difference between "personal" and "private" property.

Higher-level management training for senior cadres could also be organized with relatively small investment. Such training could very effectively be combined with short-term on-the-job training in the United States. The director of an Estonian business school that operates on this model told me that the true measure of the success of his school lies in the fact that nine out of ten of his students, who are mostly senior managers and factory directors, immediately leave their state sector jobs upon graduation and go into private business.

In southeastern Europe as elsewhere, the worst assistance is the kind one comes to expect and become dependent on: such a state of affairs must be avoided at all costs.
COMMENTS

A. Ross Johnson

The issue addressed by the conference—how can the United States support the development and consolidation of democratic politics and free market economies in postcommunist Eastern Europe—is a matter of strategic importance. Communist power in and Soviet domination over Eastern Europe must not return. A modicum of stability is essential, both for Eastern Europe and for Europe as a whole. The European Community may not be able to “afford” new Eastern members for the foreseeable future. But it also cannot “afford” economic collapse, environmental catastrophe, political chaos, or ethnic conflict on its Eastern borders. Relative success in Eastern Europe can have a positive impact on the development of the USSR or (more likely) its successor states. American involvement in this process is important, as part and parcel of the involvement of a nonisolationist America in the post–Cold War Europe.

The context of this challenge should be kept in view. Eastern Europe has the dubious honor of attempting for the first time in history to recover from the political and economic shambles of communism. It lacks the concentrated shock of defeat and massive destruction in wartime—the Zero Hour—that resulted in changed outlooks and self-sacrifice in postwar Germany and Japan. But there is nonetheless remarkable consensus in Eastern Europe, and in the West, on present objectives. Central Europe wants to be part of Europe. “Third way” thinking has been largely discredited throughout the region (although traces of it survive in Romania and elsewhere). The goal of developing free market economies is accepted by all parties. Pluralist democracy is the political aim—albeit with varying modalities and content. Eastern Europe aims for closer security ties with the West, including the West European Union and NATO.

There is a difference in these and other respects between Central Europe (Poland, Czechoslovakia, Hungary, Slovenia, Croatia) on the one hand, and southeastern Europe (Romania, Bulgaria, Serbia) on the other hand. Alex Alexiev and James Brown have discussed these regional differences. Their papers are complementary; Alexiev traces

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the differences, while Brown notes the limits. Bulgaria, Romania, and Serbia emerged from the Ottoman Empire, and they lacked some of the civic institutions and traditions developed by successor states to the Austro-Hungarian Empire. Yet their peoples share the aspirations of states to the north to be Europeans (with free market economies and pluralist politics). Even if they did not, Europe (like the United States) could not today accept second-class or “Balkan” criteria on human rights, minority rights, or other issues for the southeast European states. Hence the conditionality of recent Western policy toward Romania.

Western policy can indeed, as Graham Allison and Robert Beschel suggest, help promote democratic developments in Eastern Europe. The poor record in the Third World, and the conditions that prevailed in prewar Eastern Europe, do not negate this proposition. In isolating Eastern Europe from the West for most of a half-century, the Soviet Union caused the region to see itself increasingly as European and not as something in between, whether “Mittel-Europa” or “Balkan.” Budapest is much “closer” to Brussels today (in terms of how political and economic issues are defined) than it was to Vienna in 1900 or 1930.

There are many instruments by which the United States can help promote democracy and free markets in Eastern Europe. Allison and Beschel have listed many of them in their paper; it is important that these be placed in order of priority and that the United States and Western Europe not approach Eastern Europe in a patronizing way. That would be all too reminiscent of Soviet behavior in postwar Eastern Europe. For the West as a whole, the principal challenge is to assist East European free market economic development, a “Marshall Plan for Eastern Europe” under present circumstances. The United States, while contributing to economic programs, also has much to contribute in the realm of ideas. Rising East European decisionmakers and opinion makers without prior American experience should be invited to the United States. American information programs—Radio Free Europe, USIA activities, Voice of America, private-sector informational activities—should continue. RFE/RL audience and opinion research, and listener feedback, document the East European demand for American as well as West European information on democratic institutions and practices, entrepreneurship, objective journalism, and much more. Imparting American ideas to East European leaders and peoples should remain a major component of SEED initiatives.
COMMENTS

Jan Nowak

STRATEGIC OBJECTIVES

The United States has no strategic or economic interest in Eastern and Central Europe other than an ideological commitment to promote democracy. Historically, interest in this area was associated with either a German or a Soviet threat. From the American perspective, Eastern and Central Europe should be viewed not in isolation but in the context of developments in the Soviet Union and Europe west of the Oder-Neisse border. Bipartisan U.S. policy pursued by a variety of economic and political measures contributed greatly to the nonviolent movement from a communist totalitarian system toward democracy.

The end of the Cold War created an entirely new strategic situation. The old world order collapsed; the new one has not yet emerged. It is uncertain who will be in control of the present Soviet military potential and nuclear arsenal two or three years from now. Will the Soviet Union disintegrate into independent national states, or will it be a federation or confederation of 16 republics? Or maybe another empire will emerge, dominated by the national ambitions of Great Russia. No scenario—good or bad—can be ruled out at the present time.

Since the birth of Solidarity ten years ago, the developments in Poland, and more recently in the rest of Eastern and Central Europe, have led to the collapse of the Soviet system in the USSR. In turn, the feedback of changes in the USSR made possible the formation of the first noncommunist government in Poland, removal of the Berlin Wall, and eventually the emancipation of six nations with a total population of 122 million.

In the future, the fate of nascent democracy in Eastern and Central Europe may have a decisive influence on the direction of political and economic reconstruction in the Soviet Union. The failure of economic reform could plunge the area into conditions similar to those of the Weimar Republic before the advent of the Third Reich: galloping inflation, massive unemployment, and general frustration among the

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population. Deteriorating economic conditions and disenchantment with democracy may easily bring to power militant, nationalistic dictatorships. On the other hand, the visible success of a free market economy and democracy would strengthen the pressure for similar reforms in the Soviet Union. It is therefore in the vital interest of the United States and other industrial powers that the experiment in democracy in former communist satellites of the Soviet Union should not end in failure but in visible success. The awareness of what is at stake should give a sense of purpose to the U.S. policy of economic aid.

THE CRASH PROGRAM OF ECONOMIC REFORM IN POLAND

For understandable reasons, Poland has a priority in the U.S. policy of promoting economic transformation from a command economy to a free market economy. As of January 1, 1990, the noncommunist Polish government embarked on an unprecedented crash economic program. Within six months, Deputy Prime Minister Balcerowicz, following strictly the prescription of IMF, undertook several drastic measures to restore stability and lay the legal and economic foundations for a competitive, free-enterprise system. Most of the subsidies and tax exemptions were eliminated. Fiscal discipline was restored. The astronomical budget deficit was reduced from approximately 8 percent to only 1 percent of GNP. Inflation, which was raging at 960 percent in January, was down to 21.6 percent in August. Ninety percent of prices were decontrolled. The exchange rate of the zloty, established in January at 9,500 per U.S. dollar, has remained stable without intervention from the Central Bank. The currency was made convertible, and the Central Bank was separated from the Treasury. Most of the import and export restrictions were removed, and customs tariffs were lowered. Hard-currency imports declined by 22 percent, while exports increased by 23.5 percent. As a result, the trade imbalance brought a surplus of $2.7 billion.

In July, legislation allowing privatization of state-owned enterprises was passed by the parliament, and a pilot project affecting 12 large state concerns was introduced. It is expected that all smaller state enterprises employing less than 300 workers will be privately owned by the end of 1991.
SOCIAL AND ECONOMIC COSTS OF TRANSITION

The social and economic costs of the reform are staggering. Sold production in the state sector dropped by about 25.7 percent, while production in the private sector increased by only 2 percent. GNP as a whole declined by 15 to 16 percent. Real wages fell 35 percent in the first seven months of 1990. Unemployment rose from 56,000 in January to 820,000 (6.1 percent of the labor force) in June, and will probably reach 1.5 million by the end of the year. No other democratic government could survive such drastic deterioration in its standard of living in less than one year. Yet the Polish people will have to wait another two or three years before substantial improvement is expected.

EXISTING THREATS

The Polish experiment in democracy and a free market economy is now facing external as well as internal dangers. The first comes from the collapse of the Soviet economy. As of January 1, 1991, the delivery of gas by the USSR was reduced from 8 million to 5 million cubic meters. Soviet gas is delivered by pipeline. There are no corresponding facilities which would allow the import of gas from other countries. At the same time, imports of Soviet crude oil—currently 13 million barrels a year—may be reduced to zero. Limited unloading facilities at Polish ports allow for only one-third of total Soviet imports to be replaced by imports from other countries. Imports of other goods from the Soviet Union also are declining sharply, and the Polish surplus in trade with the USSR has been increasing. Any restrictions of Polish exports to the USSR would raise unemployment in Poland to unacceptable levels.

The economies of Hungary, Czechoslovakia, and particularly Bulgaria are even more vulnerable to a possible collapse of Soviet production and foreign trade. Comecon was providing markets for industrial goods produced by its member states in what amounted to barter trade. Industrial production of the former communist states cannot compete in the hard-currency markets of the free world.

The oil crisis has been compounded by Poland's participation in the blockade of Iraq. Iraq was repaying its debts to Poland by providing one-third of Poland's oil imports. Buying oil for dollars at much higher prices would have a severely adverse impact on Poland's balance of payments.

The reunification of Germany will deprive Poland of its second most important trade partner: East Germany. The GDR and the USSR
together represented more than half of Polish trade. Negotiations between East Germany and Poland on existing mutual economic commitments have made no progress.

The third danger to Poland's still fragile democracy is of a political nature. Until now, the difficult task of democratic and economic reconstruction has been based on a general consensus. The Polish people have displayed unexpectedly high levels of tolerance for the considerable hardships brought about by reform. The situation changed on May 9th when Lech Walesa proclaimed "permanent political warfare" against the Mazowiecki government, which he himself had created only eight months earlier. In the name of pluralism and the necessity to accelerate dismantling of remaining elements of the communist regime, the Solidarity movement was split into two hostile camps headed by Walesa and Mazowiecki. The alliance of workers, intelligentsia, and farmers that played such a crucial role in the success of democracy was brought to an end. The ensuing public criticism of Mazowiecki's government with populist slogans has eroded popular support and created a climate for social protest.

The campaign in the first fully free and democratic presidential and parliamentary elections exposed the weakening of the present ruling team in the middle of the risky and difficult process of political and economic transformation. Walesa accused Mazowiecki of proceeding too slowly in dismantling the communist nomenklatura and of an excessively restrictive wage policy. Walesa's critics, on the other hand, were concerned by his authoritarian tendencies and his announced plans to "rule by using an ax and decrees." The chairman of Solidarity still enjoys the broad support of workers and people in the countryside, who consider him a symbol of success and place their trust in his instinctive wisdom. Even Walesa's most outspoken critics still entertain hopes that the charismatic leader of Solidarity may restore his cooperation with the new elite that emerged in the ten years of Solidarity's struggle for freedom and democracy.

FOREIGN AID

The assistance offered to Poland by the EC Commission, IMF, the World Bank, and 24 industrialized nations amounts to a little less than $9 billion. The United States contributed $753 million—about 8 percent. The United States, however, played a leading role as an international "fundraiser." Without the administration's initiatives, leadership, and prodding, there would be no international assistance of such dimensions. For instance, the American grant of $200 million to the stabilization fund was offered on condition that other leading
industrial powers would contribute the balance of $1 billion. The fund made possible the stabilization and convertibility of the Polish currency.

RECOMMENDATIONS

Reduction of the Polish foreign debt is considered to be the first priority. The growing burden of Poland's external debt, which has reached $46 billion, undermines confidence in the stability of the Polish economy and its balance of payments. Private foreign investment is discouraged by uncertainty and the risks involved. Full participation of private creditors and investors in the Polish recovery will not be possible until the debt problem is finally and permanently solved. Poland cannot continue to sustain repayments of more than 2 percent of the principal per annum. The present market value of Poland's debt is approximately 12 cents on the dollar. Thus, substantial if not complete debt reduction is essential. Precedents were established when both Germany and the Soviet Union were granted debt relief in the postwar years.

Establish priorities and ensure better coordination of various projects giving assistance to Poland. The existing programs were improvised in haste in order to provide prompt response to fast-moving changes. After one year, it is possible to establish priorities and better coordinate the various projects. Polish beneficiaries complain that they receive too much unsolicited advice, that too much money is being spent on travel, experts, salaries, and overhead, and that too great a share of the grants is spent in the United States. It is time to create a clear mechanism that would permit the recipients to present their views and needs.

A contingency plan of assistance to the Polish government should be prepared in case it is necessary to soften the social impact of growing unemployment through a major increase in public works projects.

In the present transitional phase, such instruments of American influence as Radio Free Europe and Radio Liberty should be maintained in order to assist in the consolidation of the emerging but still fragile democracies in Eastern Europe. Both radio services still have very large audiences and enjoy considerable credibility. As in the past, broadcasting may play an important role in any future crisis.
PART III

DEVELOPMENT OF FREE MARKET SYSTEMS
7. INTELLECTUAL AND POLITICAL BARRIERS TO FREE MARKETS

Leif H. Olsen

It must be pointed out that in Marxist terminology two stages of communism are distinguished. The first (called by Marx the "lower phase"), or "Socialism," is a transitional stage during which some elements of capitalism are retained. . . . The second stage (Marx's "higher phase"), or "Communism" is to be marked by an age of plenty, distribution according to needs (not work), the absence of money and the market mechanism, the disappearance of the last vestiges of capitalism and the ultimate "withering away" of the state. The USSR, socially the most advanced Socialist country at present, is vaguely scheduled to start entering the second stage about 1980.¹

The decay of the communist command economies in Eastern Europe and the Soviet Union has been underway for many decades; while in process, it offered little drama to those outside these countries except for the comparatively few professional observers. For everyone else the drama came in November 1989, when the Berlin Wall came down. In terms of the social sciences, these events offer extraordinary opportunities for study and the advancement of knowledge in both the political and economic sciences. It is for that reason, among others, that this paper contains a number of references to how some scholars in both these disciplines expected the socialist communist economic systems to evolve.

The other reason this paper contains some theoretical and philosophical views is that I expect that a number of papers presented at this conference will more than adequately cover proposals for financial aid and the content of assistance programs.

How people think about economic systems will reveal their receptivity to change and their ability to manage change. Thus I have endeavored to introduce some points of view which may be different from the main stream of the discussion.

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THE INVISIBLE PROBLEMS OF ECONOMICS

The task of successfully implementing market economies in Eastern Europe and the Soviet Union and allowing them to flourish will be encumbered by a series of unfortunate characteristics of economies managed by individuals in a political and legal setting. The hazards are multiplied by the exhilaration of the speed of events, which dictates quick action, short cuts, and the immediate adoption of what appear to be the most attractive parts of free market economies and the expectation that they will very shortly deliver "the goods," literally and figuratively. It is sobering to recognize that such economies have evolved over a very long span of time and that certain essential pieces came into being only through experience, trials, and adaptations.

From time to time I will elaborate on the shortcomings of centrally planned socialist economies. This is done as a reminder that when faced with the unprecedented problems of unscrambling the egg of capitalism, the people in Eastern Europe must remind themselves of the bankruptcy of the former systems. Before discussing some of the specifics of these economies, it is useful to examine a number of the challenges facing individuals in Eastern Europe as they create a framework of the more successful economic principles.

I would like to begin with a proposition. We find in society and academe a conventional view that the physical sciences, such as physics and chemistry, are difficult for the human mind to grasp and use in practical applications, while social sciences, such as economics and political science, are easy to comprehend. In fact just the opposite is true. Personal value judgments and political views are much less likely to bias research and conclusions in the physical sciences than in the social sciences. The presence of value judgments dilutes rigorous analysis in the social sciences and provides wide latitude for incorrect or illogical conclusions, and this impedes the advancement of knowledge. In the social sciences, we still see many examples of 14th-century technology. In contrast, the physical sciences have made giant strides in this century in the areas of transportation, communications, and data processing, to name but a few.

Economics is difficult because as a social science it is not susceptible to precise measurements, and it is plagued by the political judgments of its practitioners, which include not only trained economists, but politicians, businessmen, and other social scientists. Economics is even more exasperating to the business and political communities because its language is math, a math which offers only approximations. Furthermore, economics is widely interpreted by a line of de-
ductive reasoning that impedes the advancement of knowledge, namely, "Whatever is plausible and self-evident must be true and requires no further analysis." There is empirical evidence supporting economic theories that should be used in drawing conclusions. Yet such evidence is often at the center of disputes driven by differences in political and related value judgments. To all this we must add the pervasive intellectual arrogance of economists (with some notable exceptions) who cannot or will not communicate ideas in simple prose. Physicists do not have any essential need to communicate broadly with the public, politicians, and the media. But economists cannot avoid it if they wish to advance their ideas and fulfill a major role for their discipline.

Whether or not economics is a science is in the eye of the beholder. A physical scientist comparing economics to the rigor required in his field would argue that economics is not a science. An economist comparing the measurements in his field with those of sociology, for example, would insist that economics is a science. The obvious answer is that we must treat economics as a science by demanding thorough analysis and conclusions as value-free as possible. One result of such an approach is that its body of conclusions is likely to displease people on both ends of a political spectrum.

An economist cannot objectively use economic principles to achieve "fairness" in society. Economics is not a discipline that conveys compassion. Yet many economists endeavor to manipulate economic theory in ways that seek to achieve what they believe to be fair. In doing so they generally seek objectives that are inherently contradictory, such as high wages but low prices, or rent controls together with an ample supply of housing. Proposals for economic change in Eastern Europe will not be free from such distortions and the unfortunate consequences.

In a democratic society, value-free conclusions in economics are not easily achieved. When economics becomes subject to law, it is interpreted by lawyers, by judges, and directly or indirectly by the writings of economists. These interpretations seldom reflect a rational set of economic principles. For example, free markets are extolled in U.S. political speeches. Most Americans are rejoicing over the collapse of the Berlin Wall as a symbol of the victory of our free market system over the centrally planned socialist economies of Eastern Europe. Most people would unhesitatingly characterize our economy as free market oriented, which for the most part it is, in spite of the fact that free markets in the United States are resisted by businessmen, consumers, and government. Even the private owners of capital are fre-
quently required to justify their legitimacy in defensive interplay as adversaries opposite government.

For one reason or another, economics does not excite much interest in highly educated people from other fields. This should not be taken to mean that economists have broader interests. To the contrary, some are so narrowly focused that they can scarcely make any contribution to the discipline. There are notable exceptions to this generalization, and where they exist, significant improvements in the practical application of economics takes place. For example, RAND seeks continuously to achieve a cross-fertilization of disciplines, as does the Law and Economics Center at George Mason University School of Law. Nevertheless, economics, along with political science, needs a close interaction with and critical interpretation by all major groups in society, particularly government.

A political scientist's explanations for the recent events in Eastern Europe and the Soviet Union provide many important elements that an economist would omit. Yet the political explanation would also omit many essential details about a seriously flawed economic system. These two disciplines must join together to structure a free market economy in that part of the world.

In the union of these two disciplines in actual practice, economics always becomes the handmaiden of politics, to the detriment of general welfare. J. Wilczynski wrote in 1970 in *The Economics of Socialism*:

> It is not without significance that between 1928 and 1954 no textbook of economics was written and published in the Soviet Union. The majority of writers were preoccupied with interpreting Marx, in order—as was concluded at the Conference of Polish economists in 1967—to provide apologetic justification of current economic policies. Yet neither Marx, nor Engels, nor Lenin ever presented a systematic and complete treatment of economic theory, particularly in respect of the allocation of resources, demand analysis, consumer equilibrium and foreign trade.

### FREE MARKETS

The creation of free market economies in Eastern Europe is an overwhelming task. The discussion of economic programs within the confines of a brief paper can only hope to stimulate a discussion. The value of this paper and of the discussions embraced in this conference will be found in drawing attention to the less obvious needs and potential pitfalls, such as separating in time decontrol of prices and

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2 Wilczynski, p. 29.
wages from privatization. If government still owns enterprises, they are not likely to allocate resources to maximize the advantages of market prices. Another example would be delays in the creation of service industry infrastructures, such as competition in distribution, the availability of liability insurance, and the creation of media information systems in business, industry, and labor. Apart from the difficulties of a systematic and rapid introduction of economic and business elements, there are pitfalls in assuming that everyone agrees on or understands what is meant by free market economies. As noted later, even in the United States there is no clear agreement on and even subliminal hostility to free markets.

Charles Wolf asked me to discuss how the free market system will be promoted by undertaking or avoiding actions, programs, and policies in the areas of monetary and fiscal measures, price and wage deregulation, capital market development, legal frameworks for property rights and dispute resolution, privatization, social security and unemployment insurance, currency convertibility, etc. These elements are, of course, among the institutional structures of free markets. They are the essential components in the blueprints for those who undertake to construct free markets. Many of these elements already exist in various forms, in some cases designed to serve a centrally planned economy. Furthermore, some progress has been made, certainly in Poland and Hungary, in the establishment of free markets. Here is how David Lipton and Jeffrey Sachs, economic advisers to Solidarity, describe recent accomplishments:

As of April 1990, several initial goals of the stabilization phase of Poland's program appear to be within reach. The corrective inflation has subsided, and aggregate demand has been sharply reduced. With tight demand and currency devaluation, Poland has been able to introduce a convertible currency, a liberal trade regime, the free determination of most goods prices, and a reasonable set of relative prices including those for energy and food.3

What is actually described here is a very limited start: the initial burst of individual initiative in small businesses once economic freedoms are granted. As Lipton and Sachs discuss in some detail, "Poland faces enormous challenges in the months ahead."4 The guiding principles and structure of a centrally planned economy still remain in such areas as wages, resource allocation, investment, and government ownership of capital.

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4Ibid., p. 125.
It is far beyond the scope of this paper to catalogue the existence or stage of development of free market economic elements in Eastern Europe. Thus I assume, purely for the purposes of this discussion, that they do not yet exist, while acknowledging that in actuality they do exist.

LEGAL FRAMEWORK

The first and most basic element in the creation of a free market economy is the creation of a legal framework. The establishment of this framework may provide an immediate test of the extent to which political freedom has been gained. In *Capitalism and Freedom*, Milton Friedman notes as follows:

Economic arrangements are important because of their effect on the concentration or dispersion of power. The kind of economic organization that provides economic freedom directly, namely, competitive capitalism, also promotes political freedom because it separates economic power from political power and in this way enables the one to offset the other. Historical evidence speaks with a single voice on the relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organize the bulk of economic activity.5

Law must secure the rights of private ownership of capital, the transfer of such ownership, the right to sue, and the settlement of disputes. This should cover not simply rights to own real capital, but also intellectual and other forms of intangible property. In the Soviet Union, time and events have probably obliterated the rightful claims of the primary owners of property confiscated by government when the communists came to power. However, this is not true in Poland. As privatization moves forward, laws must be established to provide for the settlement of such claims. In East Germany, such claimants are being indemnified by the now-combined Germans. Some may argue that claims of prior owners should not extend to the governments that succeed the communists. Unquestionably it is a moral issue. The costs of moral wrongs are ethereal. They live for a long time and undermine the integrity of successor governments and thus the confidence they inspire.

Government must be made subject to laws governing economic freedoms. This is particularly important in order to prevent special-in-

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terest groups from achieving favored treatment, as has happened in our own country. The legal codification of market economies in Eastern Europe will be aided by the fact that many of these countries had such laws prior to World War II. In addition, they may well select from the legal codes of other European countries. We should share with them our own experiences, both good and bad. Our government has evolved over time and now contains many limitations on economic freedoms that the Founding Fathers did not intend.

The legal principles underpinning such law in the United States begin with the Constitution, but over time the interpretation of the Constitution has created a body of law that has become more restrictive with respect to property rights. As James A. Dorn has noted, "The demise of economic due process began in earnest in the late 1950s, as the Supreme Court decided not to give property rights and economic liberties the same fundamental rights and civil liberties. With this judicially created distinction in hand, argues Siegan, 'legislatures have great difficulty in restraining freedom of speech or press, and almost none in curtailing freedom of enterprise.'" 6

The creation of a body of law to support market economies can easily be implied by discussions about the economic structure. Legislation will provide for privatization, liberalization of prices and wages, the creation of specific financial market institutions, etc. However, as we know from our own experience, there must be a basic body of political principles establishing the ethos for an economic system that will initiate a systematic code of law. Piecemeal legislation would create future problems. Benefiting from mistakes in mature free market economies, the objective in Eastern European countries should be the creation of as complete a body of law as possible, adopted at the time public and political zeal is at its peak. If this is not done, undesirable legal features will develop in the future to fill voids. If there is one thing that is certain, it is that their zeal will greatly diminish at some point.

We know from experience that there is a conflict between the legislative and the judicial branches of government. The judiciary often "legislates" with the encouragement or the acquiescence of the legislature because interest groups perceive that in the course of a political debate the legislature will fail to adopt a law which is sought. Peter H. Aranson writes of this tendency:

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The notion of judges as economists seems philosophically objectionable, because it eviscerates any notion of the judiciary as a protector of rights. . . . If judges acted as legislators, their actions would incorporate in the judiciary all of the failures of legislatures, threaten judges’ independence, and obliterate any reasonable control that judges now exercise.

The judiciary, and particularly the Supreme Court, should not follow the mistaken path of trying to substitute its own educated economic judgments for the legislature’s political ones. There is scant evidence that the Court enjoys a comparative advantage in such a contest.7

If the creation of new laws for an economic system is dictated simply by an arbitrary, or worse, political decision that the next piece of economic structure requires it, the process could be a lengthy one. There is then the risk that an incomplete body of laws will be enacted and that the judiciary will be led to engage in the kind of mischief set forth by Aranson.

PRIVATIZATION

The sale or transfer of state-owned firms to private citizens must be discussed within the context of several problems. First, the removal of price and wage controls should precede privatization. This step will initiate the reallocation of resources through market mechanisms, and it will help to determine the true value of existing firms where prices and wages are determined by the market. Without this step, privately owned firms will be operating with the same debilitating controls that have produced the current state of affairs. This step is necessary to eliminate opportunity costs that permeate economies where asset allocation is determined by a central planning authority making arbitrary political decisions.

As an example of the distortions of such allocation, we have the spectacle in the Soviet Union of insufficient labor and machinery to harvest a bumper crop. In the past, labor shortages in an emergency were dealt with by instructing state enterprises to send workers into the fields. This resulted in losses at factories. Such losses used to be forgiven, but recent accounting changes directed toward making enterprises more self-financing have left such forgiveness uncertain. Hence the response to calls for help in the harvest was muted.

There were also shortages of combine parts, railroad cars, and storage facilities. These shortages are all characteristic of an economy that is driven by controls, rather than by free prices. Freeing prices and

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wages will not only allocate resources more efficiently among existing industries, it will spawn new firms, particularly in services, to fill large gaps that now exist in a command economy.

The second problem of resource allocation is that there is no organized market for the purchase and sale of government enterprises. Contention bidding for government-owned firms has already emerged in Eastern European countries. Workers assume that they are the natural owners of the business. Government-appointed managers believe they are simply the "inheritors" of the firm from a defunct government. David Lipton and Jeffrey Sachs have said: "It seems clear to us that any transfer program that will win widespread political assent must indeed involve at least partial transfer to stakeholders, . . . such as workers, state banks, and the local government in the region where the enterprise resides . . . rather than simply a transfer of ownership directly to households."8

I believe there is merit in employee ownership. But how is it to be achieved? Lech Walesa and the Solidarity Union would like to see ownership distributed 40 percent to the government, 20 percent to the workers, and 40 percent to private owners. However, it is a mistake to retain any ownership by government or government-owned banks. Among the serious deficiencies of centrally planned socialist economies is the absence of competition among firms in the same industry. In Poland, for example, the pharmaceutical industry functions through one company, called Polfa, with thirteen noncompetitive subsidiary companies. Any retention of ownership by government, which will undoubtedly retain powers to regulate, will inhibit competition from newly created nongovernment-owned entities. Since such entities are likely to be created by joint ventures with foreign companies, the continuation of government ownership in industry will stop any significant foreign capital inflow to Poland.

Ownership in government firms should be sold entirely to private owners. That does not rule out purchases by workers' groups through Employee Stock Ownership Plans (ESOPs) or through stock option plans by managements. "Selling" shares will force the creation of a market structure, no matter how primitive it may be at the outset, and it will establish the principle of capital creation. Capital is created because current consumption is forgone and the savings are used through direct lending or through the purchase of securities to enable someone to use it to create real capital, i.e., machinery, equipment, and buildings.

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8Lipton and Sachs, p. 130.
Once it is determined that equity shares should be sold, the next question is how such sales should be managed. Any political intrusion will defeat the most desirable outcome if all of society is to receive the benefits of more efficient allocation of resources and higher standards of living. One possible approach to selling ownership in government firms is through a national lottery. This would eliminate the personal administrative element that is susceptible to deep resentment because of perceptions of a possible lack of fairness. The successful holders of lottery tickets would have the right to buy shares. They could also sell their winning tickets to others if they prefer not to forgo current consumption to undertake the purchase of stock or the interest cost of financing such purchases. It may take several lotteries to accomplish privatization. However, laws should be created to prevent government from retaining any ownership beyond a fixed date.

The changes in Poland have been wrought in part by the Solidarity Union. It wants each company to retain a works council with the power to discharge the chief executive and to review annual profits to see how much should be paid to workers as bonuses and to shareholders as dividends. This reveals, not too surprisingly, that market economies are not entirely understood or that they are not entirely appealing to significant interest groups in Poland. Establishment of a works council would mean that the effective management of the company would reside with the workers. If they are also owners, it might be successful. But it would require extraordinary leadership in the works council to allow the hiring and firing process to function as it must in a free economic environment and to pay the market price for capital. Obviously the retention of such a vestige of the socialist system would, over time, severely damage the ability of the company to attract capital.

Ownership should be conveyed in such a way as to assure effective management. This can be done through stock options tied to performance. Stock options can also be allotted to worker groups on the same basis.

Valuation techniques should be used to ascertain the total value of the firms, although share prices should be low enough to encourage as broad a participation as possible with the aid of financing. Due diligence should be a shared responsibility between the borrower and the lender. In other words, the credit terms should be written in such a way that the borrower is not solely responsible for determining the likely success of the firm.
The objective in selling shares is not to maximize the value of the firm to the government, but instead to convey ownership to the private sector. The government will realize its benefits from the development of a strong, well-balanced tax base and the security stemming from the well-being of its citizens.

These benefits of private ownership will flourish more rapidly and with greater certainty if there is no effort to retain what some might regard as the "better features of socialism." Autocratic management, whether it occurs in a business or in government, destroys the collective initiative of the governed, and it undermines the organization's ability to match the achievements of an organization in which individual initiative is allowed and encouraged. Psychic income provides effective incentives for many people to excel in their endeavors. But such rewards are not perfect substitutes for material rewards related to performance, since psychic rewards cannot provide food, shelter, and clothing.

The destruction of individual initiatives in an entire nation and the muting of material rewards for performance are deadly to human welfare. Privatization provides exactly the opposite effect.

**PRICE AND WAGE DEREGULATION**

Before discussing the necessity of allowing market forces to determine prices and wages, we might gain some perspective by recalling, through the pages of Robert L. Heilbroner's book *Between Capitalism and Socialism*, a famous debate over the ability of a socialist economy to survive.

The most intellectually respectable criticism of socialism in the mid-1930s was the effort of Ludwig von Mises and Friedrich Hayek to destroy the credibility of socialism as a desirable social order, not by inveighing against its ideals or its excesses, but by demonstrating that the economic system on which it was based would not work.

In brief, their criticism was based on the contention that socialism was intrinsically unable to achieve a rational economic order—that is, a system in which all the factors of production were employed as efficiently as possible—because it lacked one critical mechanism: a market in which capital could be valued by the free offers of owners of capital and by the free bids of would-be hirers of capital. Since by definition there could be no private ownership of capital no free market price for it could ever be ascertained. As a result, the only way of deciding which enterprises were to have capital, and which were not, was perform the essentially arbitrary decision of some Central Planning Board. Such a system, it was presumed, could not long endure.
This line of attack against socialism did not fare very well. In the mid-1930s it was effectively demolished by Oscar Lange, the brilliant Polish economist then at Harvard. Lange demonstrated in two incisive articles that Mises had failed to see that a Central Planning Board could indeed plan rationally for the simple reason that it would receive exactly the same information from a socialized economic system as did entrepreneurs under a market system. The only difference was that the Board would not learn about the condition of relative scarcity or plenty of capital goods or other commodities by price changes, as under capitalism, but by the building-up or running-down of inventories. That is, when a good was underpriced, instead of its price going up, as in a free market, the planners would discover that supplies of the good were being depleted faster than they were being replaced. All the Board would then have to do was to raise the price until the level of inventories was again constant. As a result, it could allocate its resources quite as efficiently as any capitalist system.9

Hayek and von Mises have been proved right, but they failed to consider the capacity of an authoritarian, nonpluralistic society to long endure the economic hardship of a system that "would not work." While this discussion centers primarily on the price of capital, it effectively deals with the price of all economic factors. I provide it here because price theory, which is one of the least disputed, most agreed-on theories in economic literature, seems to be the least understood by the public even if it is the beneficiary of market economies. Prices are essential to convey information. They are not intended to extract income from buyers.

When Lange argued that the Central Planning Board could simply move prices in response to inventory changes, he avoided any reference to kinds of inventories. He assumed, as did other socialists, that prices did not function to provide information about what kind of goods people wanted. As every visitor from Western nations knows, the range of goods offered to consumers in centrally planned economies is very narrow. It is so narrow, in fact, that despite comparatively high employment and the availability of income, the quality of life is much poorer than in free market economies. The price of a good or a service is not expressed solely in the money price tag, but also in terms of quality. Thus even "low" money prices may be high if the quality of the goods is poor. A noncompetitive, centrally controlled market results in a comparatively narrow selection of goods that are "high" in price because of poor quality.

Prices and wages (the price for labor) freely determined by the market will result in the efficient allocation of resources.

**CREDIT MARKETS**

I will not dwell at length on credit markets. Banks must be among the government firms to be privatized. While there are libertarians who oppose central banks and money issued by government, I am not one of these. In any event, I prefer to propose what may be achieved. I doubt there will be any serious obstacles to the creation of a central bank. There will undoubtedly be disputes about whether it should be subservient to the treasury. While we may hold the independence of the Federal Reserve to be sacred, I prefer to hold it accountable. That accountability may be much more direct and clear if the central bank is responsible to the executive branch of government. Moreover, monetary policy should not be carried out by a large committee. A committee of three is a logical number and will make accountability less obscure.

Consumer credit, including amortized mortgages, came along somewhat late in the development of credit markets in our own country. Consumer credit should not be delayed in Eastern Europe. The development of assembly-line production in automobile manufacturing is known to almost every schoolchild. But ask about the origin of consumer credit, which made it possible for households to acquire durable goods with long useful lives, and you will get no answer. Consumer credit is essential to increases in standards of living.

**INSURANCE**

Life insurance is an essential financial services product that needs no great elaboration. Liability insurance is also essential to encourage risk taking. It provides guidelines and costs of risk necessary to the rational conduct of any business.

**FUTURES MARKETS**

Risk taking is also encouraged and spread through the development of futures markets for commodities and financial instruments. It has obvious benefits for agriculture.
DISTRIBUTION SYSTEMS

In Poland there is a single government-owned agency that handles the distribution of goods and services within the country. It collects a fee of 8 percent for its services. This system must give way to privately owned, multiple systems for different industries that will reflect marketing skills. Distribution systems assume considerable risk in the success of businesses, and if they are not competitive they will not become efficient. This is equally true in the field of exporting and importing.

Under the existing arrangements, the government collects and provides foreign exchange. Individual firms are not permitted to earn foreign exchange directly. This policy should be changed to provide an incentive to exporting and to provide for the rational flow of foreign capital needed for specific kinds of exporting industries.

FOREIGN CAPITAL AND JOINT VENTURES

Capital flows to where it is well treated, and it bestows commensurate benefits to those who provide a hospitable environment. The process begins with the treatment accorded capital owned by residents of a country. Capital flight will not encourage nonresidents to risk their investments in a country where it takes place. This is a hard lesson for societies to learn. It has yet to be learned in Central and South America.

Foreign joint venture partners will seek sovereign risk protection, i.e., risk against confiscation and exchange restrictions. These foreign partners will seek access to domestic markets in a given country, or export advantages arising from proprietary technology or low costs.

In most of the East European countries, low labor costs will be the initial source of foreign exchange earnings. Tourism, which requires accommodations, transportation, and communications, is an industry that typically earns foreign exchange in developing countries. Another source of foreign exchange can be developed rapidly through joint ventures with foreign companies that have superior, but labor-intensive, technologies. The history of the development of Asian and Pacific countries offers an excellent guide to this development. Those countries began as low-labor-cost producers. But they simultaneously raised the value of human capital through education. It is noteworthy that the largest single group of foreign graduate students in the United States today is Asian in origin. Many of these countries, from Korea to Malaysia, are now striving to develop their own indigenous
high-technology industries. One thing countries along the Pacific Basin have in common is comparatively free market economies.

Poland's export markets, together with the other East European countries, have been within the communist bloc and, importantly, with the Soviet Union. These markets are no longer assured, however. All these countries have a desperate need to import technology and consumer goods from other nations. To do this they must earn hard convertible currency. This places greater importance and urgency on joint ventures which tap the advantages of the emerging economies of Eastern Europe and the overseas market access offered by foreign companies.

SOCIAL SECURITY AND UNEMPLOYMENT INSURANCE

I would oppose the introduction of social security. It has become a fiscal disaster in the United States. Moreover, the same amount of money that has been taxed to support social security would have earned far greater returns had it been invested privately. Instead, legal provisions encouraging private pension systems should be instituted. The savings in such pools would be used far more efficiently in private investment, and that in turn will enhance the tax base rather than weaken it, as has been the case with social security in the United States. Provisions should be made for early vesting and mobility of pensions. Unemployment insurance will provide an important safety net during the transition and later. However, East European countries might benefit from looking at the Japanese experience. Paternalistic arrangements between labor and management provide wide latitude in determining wages and work place arrangements. In return, workers are given comparatively greater job security than exists in other industrialized countries.

Under an unemployment insurance arrangement, labor is apt to take the attitude that it has no responsibility for the competitive cost of jobs. Labor unions in the United States and Europe are inclined to hold to their demands even when doing so means that employees must be laid off to maintain the competitive position of the firm. The logic of such a position is that government will take care of the unemployed. Unemployment insurance, like all other insurance, raises risk-taking levels, even when those risks involve unemployment.

Perhaps one way to describe the economic events unfolding in Eastern Europe, and now in the Soviet Union, is to liken those economies to an industry that has been regulated, subsidized, and otherwise protected from competition but is now emerging into free
markets. We know from our own experience with deregulation that marginal firms will fail, incompetence and fraud will mark part of the transition, benefits will now be readily apparent to everyone, and nostalgia for the prior autocratic system of communist command economies will exclude from memory its harsh deficiencies.

The Support for East European Democracy (SEED) Act of 1989 provided $200 million to support, along with funds from other countries and the IMF, structural adjustments in Poland and Hungary. These funds seek to establish the necessary structures for a free market economy and a pluralistic society. However, there is still reluctance to move to complete privatization and market-determined prices and wages. We must recognize that the first event that has happened in all these countries is the bankruptcy of central planning and socialism; it is not the winning ways of capitalism and free markets. Those ways have appeal, but even in the United States, with its years of benefits from them, there are those who would introduce restraints usually associated with centrally planned economies.

The greatest risk faced by all of the countries emerging from socialist command economies is that they might not go far enough toward freedom. Interest groups will seek to gain advantages over others, failing to recognize that the advantages they gain will still fall far short of those they would realize from pervasive acceptance of all the essential principles of market economies.

Three years ago at a RAND conference called to discuss unanticipated future shocks, no one in the room even hinted at events of the past year in Eastern Europe and the Soviet Union. And even if someone, through remarkable foresight, had described the collapse of communism throughout the world, that person would not have been believed. Likewise, there is no reason to assume that our contemporary projections of future events in Eastern Europe and the Soviet Union will turn out to be true, however believable they may be. If someone with perfect foreknowledge told conference participants what will happen in that part of the world during the next five to ten years, that person would probably not be believed. That is simply the nature of most accurate predictions. One possible way to start thinking about this, however, would be to quote from Heilbroner’s essay “A Look at The Future of Capitalism”:

However mistakenly, some form of planned socialist economy has been widely seen as the direction in which economic organization has been drifting, more rapidly in the underdeveloped areas, more gradually in the developed ones, but with ineluctable tread in all. The virtual collapse of centrally planned socialism has cleared away all such anticipations. The shape of things to come will be determined by the dynamics
of world capitalism alone—an awareness that conjures up in some minds Pogo's famous statement that we have met the enemy and they are us.¹⁰

Heilbroner goes on to discuss his discomfort with and others' criticisms of capitalism. The point is that centrally planned socialist economies simply did not work. However, what kind of "capitalist" or "free market" economies emerge in what is, to a certain degree, a vacuum remains to be seen.

Twenty years ago, in his book *Between Capitalism and Socialism*, Heilbroner said:

> Taking socialism seriously means more than acknowledging its difficulties as a political movement. It means understanding as well that socialism is the expression of a collective hope for mankind, its idealization of what it conceives itself to be capable of. When the fires of socialism no longer burn, it will mean that mankind has extinguished that hope and abandoned that ideal.¹¹

Free markets and private ownership of capital have demonstrated economic logic, but in a democracy there is a drift toward egalitarianism. We may continue to find ourselves somewhere between capitalism and socialism.

¹¹ Heilbroner, *Between Capitalism and Socialism*, p. 113.
8. ASSISTANCE TO EASTERN EUROPE FROM WESTERN GOVERNMENTS: THE FIRST STEPS

Steven W. Popper

The old order in Eastern Europe is gone. The degree of disarray in the former institutions of power is profound; these seem unlikely to play a significant part in reshaping the region. Yet, the success 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 upon resolving the economic crisis facing each nation in the region. If for no other reason, this makes the successful resolution of economic crisis an object of policy interest for the West.\footnote{The question of what the West might do actively to aid the process naturally arises.}

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

The paper 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 East Europeans themselves, there is a Western role for supporting local efforts. Stabilization and direct investment should largely be carried out by players other than Western governments. Individual initiatives from private commercial and noncommercial interests could be decisive in several areas. Yet, there remains a need for institution building; Western governments are best poised to contribute to this aspect of political and economic transformation.

\footnote{Steven W. Popper is an economist at RAND.}

\footnote{"West" is used here in the political sense, thus including Japan, Oceania, and potentially influential nations such as South Korea.}
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, that 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 still 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 reform of existing systems—a process already under way, at least nominally, for more than twenty years in some countries—but in their thorough transformation.

This systemic, or "flow" aspect to the general economic crisis is the root of the general economic malaise and 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. Most obvious, if not the most preponderant, is the debt owed to foreigners. While tractable in most countries, the accumulation of this debt 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 earning payback. Though foreign debt is a major issue only in Poland, Hungary, and Bulgaria, it provides a paradigm for visualizing several forms of debt acting as greater burdens for the future.

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

Clearly, these latter, stock problems may be alleviated by money; the former, flow problems may not. The bifurcation of the general eco-

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2 Never intended for excellence but rather to meet the output goals of what was essentially a monopsonistic consumer, 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.
nomic crisis and the dynamic connections between its two aspects frames the environment within which Western assistance must occur. Early on, the East Europeans turned to the West for help, and the West demonstrated its willingness to provide the means, if in more limited measure than some in the East hoped. The more thoughtful among the East Europeans will point out that what they wish from the West is not aid, but assistance. Aid, block grants, and resource transfers, it is recognized, could be misused. They run the danger of carrying in their wake a new bureaucratic structure which would absorb a good share of any resources. But the biggest danger is the potential for large aid grants to mitigate some of the stock problems, which are primarily the symptoms of crisis, at the expense of solutions to the systemic, flow problems, which are its cause. The greater need is for assistance to put in motion a fundamental transformation of systems.

INHERENT PROBLEMS WITH WESTERN ECONOMIC ASSISTANCE

Aid to Eastern Europe from the West is made problematic by the unique character as well as the sheer range (and scale) of tasks being tackled. Drawing upon 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 not only to squandering aid, but could, despite all good intentions to the contrary, result in a deterioration of the economic situation of the recipients.

This assertion is based upon several assumptions. Principal among these is the need for as quick an implementation schedule as possible to maximize the likelihood for successful transformation of the existing economic systems. Current discussion of economic policy in the region centers not on whether transformation is required but whether it should be rapid or more "moderate." Domestic politics will always require the time course for such a thorough transformation to be drawn out. This works to the detriment of reform. The operational essence of the process is to arrive at some point\(^3\) where the momentum of transformation begins to overbalance the inertia of the past system. The period of transition must be reduced to as short a time as possible. Drawing out reform reduces the short-term pain, often because the actual elements become attenuated, while running the

\(^3\)The temporal or even operational location of which is almost impossible to determine \textit{a priori}.\)
risk of the cumulative inconvenience and suffering sustained by the population becoming, in the end, as great or even greater with no ultimate payoff. A quick transition implies greater dislocation to the economy in the politically relevant near term and will appear as a considerable threat to rents originating from within the prevailing structure of informal property rights—stakes 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 be successful, a program for the radical transformation of a Soviet-type economy must be able to draw upon a series of wasting assets. Foremost is the climate arising from the initial optimism, hopefulness, and good will of the civil population. This asset is required for buying the time necessary for the reform to work. If it is absent, the time available to reformers becomes ever shorter, while the ability and willingness of the population to accept change from the current regime grows less and less. In this analysis, the worst thing one can do is to waste time, frittering away such assets with simplistic, ill-thought-out policies labeled as fundamental reform that 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 serious and committed to the course 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, there will be internal pressure 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 and would permit the emerging systems to attempt “reform” rather than transformation by erecting administrative and legislative solutions in preference to market-oriented ones.4 In the meantime, the population becomes skittish, even panicked, the authority of the regime dwindles, and the very word “reform” acquires a highly pejorative

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4This should not be understood as stating an extremist faith in the ability of the market to solve all problems.
connotation. While dissatisfaction may build, serious economic transformation may then only be achievable after a process of political re legitimization.

The Soviet Union 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 disequilibria to persist and allowing East European governments to postpone transformation. Removal of disequilibria and their systemic progenitors, not their 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 "leveling" in industry by formal or informal policies of taxation and subsidization resulting in resource transfers from apparent profit generators to losers has a bureaucratic persistence difficult to eradicate, especially in a period of concurrent political transformation. The tendency will most often be to 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, this 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 a true economic transformation is enacted, it would be almost impossible to ensure that resources of Western origin intended for improving some aspect of infrastructure or for investment in some branch of the economy would not ultimately have the effect of buying a bit more time for sectors contributing nothing, or less than nothing, to national income.

On the other hand, Western assistance could be a useful asset in lengthening the period of time available to a committed, well-articu-

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5 Until 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 re-examined, it will not be fully clear which enterprises are truly capable of independent, profitable operations.
lated 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 doing the latter without entailing the risk of triggering the former. 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 such assistance provides the equivalent of balance-of-payments finance, which may then be used to avoid the harder measures of reform, or pumps greater liquidity into systems already burdened by the consequences of insufficient monetary control, it is a detriment. Precisely because of the underdevelopment or nonexistence of major market-type economic institutions, this lurks as a major concern. Large-scale assistance should be targeted to meet specific purposes in furthering the ultimate goal of successful transformation to an economic system that makes more efficient use of domestic resources.

Contingency suggests aid of any significant size needs to be predicated upon a demonstrated commitment to fundamental reform in each potential recipient country. This is contentious. In many ears it sounds peremptory, as if the West is putting itself in position to force its system upon 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, it is based upon 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 long-lasting effect other than to increase levels of indebtedness. It also is a requirement for assuring 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 upon a new set of institutions and legal relations. The point is not for East Europeans to demonstrate their worthiness of assistance from the West. Rather, it is to make certain there are means in place for treating the causes of malaise, not just symptoms. Not coincidentally, this is also a requirement for successful applica-
tion of assistance. The actual events ensuing from a transformation process are difficult to predict *a priori*; they are certain to be surprising. There needs to exist a mechanism, if only a rudimentary one, that will be responsive 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.

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 and are open to argument and differing perceptions, and the time available seems short. Any coordination attempts, it would seem, are 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 East Europeans, although a good deal of this is owing to the suddenness of change and to 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, there are new leaders in a new governmental system, and even two of the ministries most relevant to economic transformation are "new." There is considerable infighting, uncertainty over turf, and an inability or unwillingness to come together over assistance issues. The government is not in a position to put out strong signals to Western partners. Besides the infighting within the bureaucracies, government programs issued to date and in prospect for the immediate future are too general. This is partly because those with technical expertise within government are not eager to make recommendations or to take strong stands. For example, the simple decision over which should have primacy in environmental clean-up efforts—clear air or clean water—is not solely technical; it is also in large part political. There is still great uncertainty over political direction and over 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.

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6The Ministries of International Economic Relations and of Industry and Trade are amalgamations of functions derived from earlier incarnations.
East Europeans often single out the EC's PHARE program as the most coordinated assistance effort. This is partly because it has a well-defined structure for determining areas for assistance and thus helps 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.

The problem of coordination among donors seems to be made even more intractable by the speed with which events are occurring. 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 upon the variety of needs of the region.

The Sources

There are four classes of potential resource contributors: international institutions (e.g., the International Monetary Fund (IMF), the World Bank (WB) and the new European Bank for Reconstruction and Development (EBRD)), Western governments either singly or in concert, and private business and philanthropic interests in the West. Each has a role to play.

The international institutions, principally the IMF, are best poised to take the lead in coordinating assistance to achieve the macroeconomic stabilization required in each reforming country. Substantial financial assistance from these or other sources must be predicated upon an agreement to a sound program of macroeconomic stabilization to be pursued in tandem with any aid program. Any assistance needs to
follow a pattern of well-defined steps whose release will be 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 the well-understood and limited character of its charter and the fact that it has no larger political agenda. It is the latter which makes Western governments so ill-suited to play a positive role in the stabilization process. They cannot be effective as an external force pressuring other governments to stay an austerity course. It is in the long-term interest of all that they remain uninvolved with the initial implementation of stabilization measures.

Private Western capital also has an unprecedentedly crucial role to play. This source has the potential of providing a substantial amount of financial inputs, of aiding in the privatization of industry, and of providing considerable technical assistance. Direct foreign investment will, by its nature, be targeted to improving 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 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 of resources from this source will be carefully targeted. It will prove to be most effective and make the largest contribution in those countries where Western business interests have most reason to believe the transformation process will prove successful. That is, the more reason there is to believe in the eventual success of the transition to a functioning market economy, the greater will be the tendency to think of activities as long-term investments rather than as attempts to gain short-term advantages from the existing economic disequilibria. The less this is so, the greater the "carpetbagging" problem—and the greater the potential for foreign investment proving a net decrement to a nation's resources. This harks back to the need for a credible program of reform to be tied to contingent stabilization assistance provided by the international economic institutions. Therefore, though not coordinated in a formal way with the stabilization process, direct foreign investment by Western business will, by following its own best interests, be tied to the success of emplacing and pursuing well-crafted reform packages.
The balance of this paper will discuss a strategy governing the assistance efforts of Western governments. 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. This last role is in many respects the most problematic. While the interests of the first two groups of players are easily defined and rather straightforward, the behaviors of Western governments have the potential for being influenced rather more by domestic and foreign political interests and pressures than by "pure" economic considerations. This, coupled with the magnitude of the resources they wield, makes them most susceptible to implementing assistance strategies with potentially deleterious consequences for the recipients. Many of these pitfalls may be obviated if Western governments consent to be bound by an additional set of rules in their assistance efforts.

Two Types of 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 implemented later during the course of the reform process in each country. The two types will also be distin-

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7 There is no separate discussion of assistance received from foundations. The prescription for the first of the two types of assistance by Western governments would apply as well to the types of programs these organizations might entertain.

8 The new EBRD, intended to become operational in early 1993, is a potentially large but currently unknown factor. It has the character both of an international agency and of 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 needs to do so judiciously, with sufficient attention to its responsibilities to assure primarily 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.

9 There is a third class, not requiring active fund appropriation. These initiatives are designed to create a climate for easier economic and other interaction between East and West. 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 East 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
guished 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 will 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, not from the amounts of money at stake. Finally, their defining hallmark is "speed."

Many of these may be put in place even before the stabilization and main package of reform measures is formally enacted. These initiatives will help develop domestic constituencies for and consensus on the direction of reforms as well as building the institutional and cadre infrastructure necessary for successfully carrying the reforms out. It would suit Western interests and would benefit Eastern Europe to have these initiatives be extensively engaged in wherever opportunity offers, that is, wherever the local governments will permit them. Because of the minimal impact 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 need. The problem imposed by the press of events is solved: each donor could and should do as much as it can in this vein at the earliest opportunity to meet perceived needs. Specific initiatives will be illustrated in the following section.

The second class of initiatives comprises programs directed to improving the physical infrastructure of Eastern Europe and helping clear several of the region's debts. These will likely be larger-scale efforts disposing of significant resources. Environmental cleanup, transportation and communication needs, and revamping of health care systems are but a few examples that come readily to mind. 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.

There are several problems inherent in larger-scale lending. So much is at stake that no one can afford, politically or economically, for individual efforts to go wrong. This leads to delay in implementation and an excess of administration. By late June 1990, East Europeans felt they had seen little or no G-24 money. What they had seen were permitted, and those of the second requiring a demonstrated dedication to fundamental economic transformation.
three or four fact-finding delegations a week. Politicians and the East European bureaucracies were overburdened by them, as were enterprise personnel. New governmental systems find it difficult to cope, and East Europeans become doubly annoyed because of their perception that such missions come at the expense of the funding for actual programs.

There are other dangers in large assistance ventures. If employed at an early date, they may be misdirected to addressing the wrong “needs.” For example, agricultural commodity assistance programs to redress what are perceived as chronic shortages in the balances of basic foods may well be inappropriate. “Shortage” may well exist because of chronic excess demand stemming from unrealistic pricing or because of shortcomings in the distribution systems. 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, large assistance ventures run the risk of providing resource transfers sufficiently large to tempt delaying fundamental transformation of the economy. The ideal for large-ticket assistance programs is to incorporate ideas of conditionality. Whereas the hallmark of small-scale initiatives was “speed,” here the defining hallmark should be “contingency.” These efforts could, and should, come later in the time course of economic transformation. They should be structured in successive steps, or tranches, and the stages should be triggered by meeting 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. At first blush, this appears beside the point, 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 might be easier to control and bring into being than it may first appear. Few potential sovereign donors will be in a position to fund
such projects by themselves. Coordination and consultation will need to occur 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.

SUGGESTIONS FOR ACTION

This section considers more specifically possible U.S. and other Western initiatives of the first type—those put into action at the earliest stage of transformation. The balance of the paper will concentrate attention on these measures inasmuch as, by definition, they will be the initial steps of a comprehensive assistance package.

Immediate Western assistance should be targeted to the core concern in preparing the way of successful economic and political transformation: making it clear to the populations of Eastern Europe that democracy will be more in their long-run interests than even the most enlightened of dictatorships. The best support for emerging democratic systems are productive, wealth-generating local economies.

The key element and the thrust of the small-ticket assistance constituting the bulk of early Western efforts should be education in its various forms. The Peace Corps program to teach English, a target of initial 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 providing a key to helping open many other doors.

Even the programs of the first type, though freer and more flexible than the second-type initiatives requiring major allocations, will need to follow certain rules to be effective. First, creation of new bureaucratic structure should be avoided wherever possible. Programs should work through existing systems on the sides of both the recipients and the donors. New structures cost time and money and erect barriers of intermediation, preventing the true needs of ultimate recipients from being heard and addressed.

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\(^{10}\)Again, 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.
Second, in general the theme of all such programs should be to train
the trainers. Programs should be targeted as much as possible to insti-
tutions of education, instruction, and training. This is the best way
to leverage whatever aid is forthcoming as well as to consummate as
quickly as possible a transformation of basic systems.

A third rule should be a strong institutional predisposition to long-
term relationships rather than short-term consultancies. The latter
are more likely to be a waste of money (as Groucho Marx so elo-
quently put it, “Hello, I must be going”), less likely to have lasting ef-
fects or contribute to synergy, but, most important, more likely to
bring in personnel with an interest in, predisposition for, or lack of
practical alternatives to their own off-the-shelf programs. Longer-
term initiatives are more likely to be molded to serve actual needs
based upon analyses of the local situation. The predisposition to
longer-term engagement needs to be hard-wired into the program
structure from the beginning. Otherwise, the exigencies of the mo-
ment and the desire of agencies to be seen to be doing something in
the short term will make it more likely for the more superficial forms
of engagement 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 in-
formal 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
agencies11 or the joint U.S.-East European enterprise finds estab-
lished by the SEED Act to act as clearinghouses collecting informa-
tion on what potential investors would wish to build in the region and
identifying the personnel and skill barriers to putting these plans into
motion. If some service or production arrangement would appear to
be favored by local conditions, but is impracticable because of the un-
derdeveloped state of training or institutional support in some area,
programs could be developed combining government and private re-
sources to provide the training. This makes for further coordination
between governments and the actions of private business.

In shaping programs, decisions will need to be made about whether it
is more efficient to train East Europeans at home or abroad. On the
one hand, cost would be greater and the number of trainees subse-

11The Department of Commerce’s East European Business Information Center
might be a natural conduit.
quently fewer if training occurs abroad in the donor country. It might even be counterproductive in some training areas where information could be imparted more easily on-site or where unmodified international practice would not suffice to meet needs and would need 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 construct such programs with built-in fuses, guaranteeing the return of the trainees to their countries of origin. Perhaps most seriously, such an approach would require developing mechanisms for selection not required by on-site programs. These then become almost irresistible objects for politicking, patronage, and local power plays.

On the other hand, an overseas program has one tremendous advantage over in situ training. One of the major problems faced by Eastern Europe is the dead weight imposed by highly structured approaches to every aspect of daily life. These shibboleths are so pervasive and so common as to be rarely perceived. They are virtually invisible to those most affected. The dead hand of what East Europeans “know” to be true, to be the accepted way to do things, is in some ways the greatest handicap the region bears. An expert coming from the West to Eastern Europe will impart what he knows, but it will often be placed by the East European trainees within their own familiar frames of reference. This effect could undercut the purpose of the whole exercise, causing undetected miscommunication. In some areas, it would be valuable to impart an entirely new frame of reference or at least convey the insight that there may be ways to achieve a given end other than the trainee’s familiar tradition. Such insights are not readily transferable in an overt process and rather need to be perceived by the trainee as a systematic totality. Scholarship programs for trainees are a means for providing this type of information transfer. While the number of such trainees may be few within an overall program, each has the potential of becoming a benign “virus” to vitalize existing systems in the home country. A few such trainees could greatly magnify the potential effect of in situ programs by providing them the tools they would require, in the form of their home-trained compatriots, to implement new approaches.

Below I list some specific programs and program elements that would be both purposeful and would meet the most pressing needs of the recipients. The intention is to provide a broad spectrum illustrating the wide range for 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 are gaining control of and responsibility for 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, find solutions to local problems, deal with environmental and public health issues on the local level, and engage in a wide range of public works projects. The expertise and tools, both analytical and administrative, to deal with these issues are profoundly lacking. Breakdowns of local government structures in the wake of systemic changes and the removal of the former integument of the local party networks would have a poor effect on 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 make certain that Western direct investment does not accrue exclusively to the capital cities.

This presents itself as a potentially fruitful avenue for assistance. An institution already existing that might serve as a bridge in promoting this development would be Sister Cities International. Government funds could be used to establish programs to send experts, set up general systems approaches to a standard package of problems, and bring over local government officials to observe the operation of local government in the United States.

Education

In line with the general recommendation to train the trainers, professional exchanges could play a big role. A particularly crucial move to support both emerging democracy and economic transformation would be to provide experts in areas such as banking, journalism, accounting, and law. The existing Fulbright or International Research and Exchanges Board programs could quite adequately be directed toward this end. In some instances, these would be "green field" ventures, putting in place educational assets never before existing. As an example, universities throughout the region are reassessing their need for large departments of scientific socialism, while there exist virtually no means for instruction in political science in the Western sense. Intellectual assistance would aid the process of conversion. Such efforts need not necessarily be confined to the university setting.
The Fulbright auspices could be used as a platform for professional seminars and training programs.

**Banking.** One vital ingredient for any successful economic transformation is the need for independent and viable central and commercial banks. In some countries there already exists a degree of expertise, 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.

**Journalism.** 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. It would be of great value in assuring the existence and influence of a viable free press to train journalists and publishers in the ethical and financial aspects of journalism.

**Law.** Although many unsatisfactory laws have been taken off the books in postrevolutionary Eastern Europe, a problem remains because few new ones have been put forth to replace them. Thus, the shattering of the former system of censorship has not been accompanied by any law governing libel or conferring other forms of press control. 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 chmoded without replacing them with a new code of business law to cover such areas as reporting and auditing requirements, contracting, and bankruptcy. There is great need for contact with Western legal experts 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**

It would be useful to have a program bringing experts from Western small business administrations to help in establishing 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 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.

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. Congress staffers, or perhaps even better, with the staffs of various state houses, would considerably strengthen staff work in East European parliaments by providing models as well as practical advice. This is 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 be focused on providing such tools as computers, related equipment, databases, and other aspects of infrastructure.

Environment

Throughout the region, environmental degradation has been disastrous. This has troubling long-term implications for public health as well as short-term economic consequences as large point source polluters are identified and shut down under public pressure, often engendering serious supply implications for economies characterized by high levels of concentration in most industrial sectors. There is a great need for libraries, databases, and contact with Western environmental control experts.
Educational Materials

There is a common need felt throughout the region and in all sectors: books, books, subscriptions to Western journals, and more books. These are vitally needed in all fields, are quite scarce, and terribly expensive to countries trying desperately to achieve some measure of fiscal control by reducing subsidies. Books are needed, wanted, will be heavily used, and thus will be 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. East Europeans find themselves overburdened with offers to establish management training centers. Much of this attention has been misplaced and is based upon misassessment of the problems ailing East European managers. It is not the skill of the management that is wanting change, but rather the environment in which the managers manage. 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 been placed in its stead. 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. This is by no means sufficient to guarantee appropriate incentives; other changes in the economic sphere will be required. But these changes will render enterprises more responsive to the opportunities presented through modification
of the economic system. This is crucial to the economic well-being of the region as a whole.

Retraining

Some thought should be spared to consider the potential for retraining intellectual workers. 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." When placed under stress, the inclination, if choice exists, is to rely on past training for solutions. Thus the tendency of the system as a whole when stressed is to revert to earlier patterns. There will be many potentially useful members of society made redundant by the profound changes in those societies. They present a danger of forming a class of disaffected formerly important persons who have little obvious place in the new circumstances (military political officers, officials of planning agencies and price offices, etc.). 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 to find their place in the new system they helped 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. This can be furthered by employing strategies to identify and place an appropriate spin on skills already possessed to 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. Throughout the world there is today a current of international cooperation running through many areas of science and technology. The major avenue for such cooperation in the East—the CMEA and in particular its large-scale Comprehensive Program for Science and Technology to the Year 2000—seems likely to become a dead letter. Further, 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) are not innate in the existing systems of Eastern Europe. There is a need to draw the East European scientific establishments into the current of international discourse.

This suggests a need for more resources and emphasis to be placed on exchanges going in both directions. The benefit the East Europeans would reap from coming to the West seem obvious. Less obvious would be the quid pro quo the Eastern visitors would provide. 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, along with an increase in the resources to maintain Westerners working with their colleagues in the East.

CONCLUSION

There remains a substantial need for financial assistance. Each nation of the region 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. Later, after the structure for transformation has been firmly established, Western governments may consider more massive infusions of material assistance to potential recipients, although the importance of private commercial efforts could be great. Such aid must, however, always maintain the primary objective firmly in view. It should be tied to assuring 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 according to the thesis of this paper it may be seen as an appropriate and vital part of a coordinated approach, however inadvertent this outcome. It is appropriate to meet present needs. Western governments should be stimulating private initiatives, facilitating co-
tacts between their citizens and those of Eastern Europe, providing expertise on the construction and rehabilitation of institutions, and helping build the skill types necessary for successful transformation to market systems. Now that time is more of a luxury than in the autumn of 1989, there is danger of enacting initiatives that may prove too challenging to the institutions of East European countries still struggling with problems of stabilization. The challenge is to make certain the legislative successors to SEED carry forward purposefully and by design what was put in place in the original by good intentions and default.
9. REFORM IN EASTERN EUROPE: WHAT MUST BE DONE? WHAT CAN OUTSIDERS DO?

Lawrence H. Summers

It's probably a good rule about many social phenomena that it takes longer for them to happen than you expect, and then when they happen, they happen more rapidly than you expect. That was certainly the case with the decline of communist economies, and one suspects that it will be the case with the growth renaissance we hope will come at some point.

My comments cover four points: (1) What exactly is the economic problem that these countries face? (2) What has to be done about it? (3) What are the limitations on what outside aid can accomplish? and (4) How can aid be used as a lever for growth? (In these comments, I think of aid in the broad sense of what the U.S. government can do rather than the narrow sense of what U.S. aid can do.)

WHAT IS THE ECONOMIC PROBLEM?
The problems in Eastern Europe—and in the Soviet Union—are broadly of three kinds. The first is the “flow problem”: They’ve got the wrong system—one that doesn’t work. Inflation is pervasive, repressed inflation is much more costly, and gives rise to queues, black markets, etc. Macroeconomic imbalances result in associated price distortions, and the lack of incentives for enterprises to do the right thing constitutes the most significant problem facing these countries.

The second class of problems concerns “socialist debts”: the hard-currency obligations to Western creditors, an environment that has been squandered and plundered and surely requires more spending to be corrected, and debt in the form of deferred maintenance and lack of investment.

The third problem category is that after 45 years of socialism, people don’t have a work ethic. As someone put it, “Well, it’s all very well to talk about privatizing agriculture and selling people their farms in the Soviet Union. There are just three problems. One is that the farmer isn’t really a farmer, he’s a guy who lives in a 12-story build-

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ing and is bussed out to the fields. The second is that his grandfather is still alive, but his friend’s grandfather who owned land was shot. And the third is that he knows he can’t get any gasoline for the tractor and the collective farm can, and they don’t come by it honestly; he doesn’t know how they get the gasoline and he doesn’t particularly want to know, but the moment it becomes his plot that will become his problem as well.”

On the other hand, one can overemphasize those attitudinal problems too much. Ryzhkov was asked what would happen if the black market suddenly went on strike, and he said the economy would collapse. The success with which the black markets operate suggests that if the incentives are there, people are people, and people respond to incentives. If there has been no permanent poisoning of attitudes, that would make a viable market economy function in these countries.

It is also true that if you attempt to estimate the magnitude of socialist debts, they are things that a well-functioning economy could very rapidly outgrow. In 1980, South Korea’s debt problem was much more serious than Brazil’s or Argentina’s; when it grew rapidly, the debt problem was resolved.

Systemic problems are in a sense a sign of opportunity. You can ask yourself why your child is doing badly and whether there is anything that can be done. It is probably better news to learn that your child is an underachiever who isn’t studying than to learn that he isn’t very smart. And in exactly the same sense, the fact that poor performance is a consequence of the system rather than a consequence of lack of human capital, the fact that people can’t work, the fact that there aren’t machines, means there is opportunity for rapid growth.

**WHAT MUST REFORM ACCOMPLISH?**

What then must be accomplished? Three things that are essential: the macroeconomy must be stabilized; the institutions of capitalism must be created; and, what is often neglected, the rules and laws of capitalism must be established. Even Milton Friedman recognized that there was a role for an iron hand supporting the invisible hand. Spontaneous privatization is a major problem in Eastern Europe. What does that mean? It means a kind of corruption that doesn’t even appear in *Barbarians at the Gate*. It is one thing to say, “I own an enterprise, I’m the manager of an enterprise, we have legislated enterprise free of centralization. That is good, but then the enterprise proceeds to turn its major supplier into my brother-in-law, in whose company I have a strong personal interest!” Laws and regulations
are needed to stop that. What stops it in the United States is not that the
decentralized shareholders of General Motors are watching and
monitoring General Motors carefully. What stops it are laws, and
laws which then establish certain cultural norms.

It is easier to draw up a list of what is different between Western
economies and socialist economies and to say that socialist economies
have to take on the features of Western economies than it is to say
something useful about the questions of staging. How fast should you
do it, and what should you do first? There is a certain amount of
naivete about the possibility of making an excessively rapid trans-
formation. Even the German miracle, when one studies it carefully,
illustrates that significant numbers of prices were controlled for sev-
eral years. There were precious few convertible currencies in
Western Europe in the 1950s, and the problem of privatization in
particular is one greatly oversimplified in some discussions.

I’m inclined to agree with a view strongly advocated by my colleague
Janos Kornai: it is tremendously important and also isn’t very hard
to get out of the way of the people in Eastern Europe who are going to
be entrepreneurs and who are going to start the businesses. That’s
the easy part. Nonetheless, two-thirds of the people do work for the
thousand largest enterprises, and you do have to think about what
will happen to them.

Some people have the image that what the British did with privatiz-
ing British Air can be done in Eastern Europe. You roll in Goldman
Sachs, you have an underwriting, you sell it, you auction it off, and
the people who pay the most get it. Britain worked pretty hard at it.
They had a determined leader. They already had the City, and they
did twenty of those privatizations in eight years! There are 7800 ma-
jor enterprises in Poland. It’s just not that easy to do quickly. And if
you do it quickly, you run into what might be referred to as the priva-
tization traps. You have an enterprise. You sell it in today’s
Czechoslovakia. The price is wrong, there is some question as to what
the government is going to hold, people pay twelve-times-earnings for
companies in the United States, they’re not going to pay twelve-times-
earnings for companies in Czechoslovakia. Suppose they pay three-
times-earnings. Then there are two possibilities. One is that it turns
out that the reform works brilliantly, in which case the people who
say ten years later that the companies were stolen at a small fraction
of their true value turn out to be right. The result is a buildup of in-
credible pressure: pressure to get at the speculators, to tax them
heavily, to expropriate, to take the enterprises back. The other possi-
bility is that the people who say that turn out to be wrong. And if
they turn out to be wrong, then the reform wasn't successful in that case.

So the specter of selling off all the enterprises quickly is just not realistic. Another reason for this conclusion is, aside from the logistics and the fact that you'll never get a fair price or a happy solution when you do it quickly, that the wrong people have the money. There's this story about Orville Faubus. Orville Faubus took office as governor of Arkansas, and he filed a statement showing a net worth of $12,000. In eight years, he left office with a net worth of $750,000. He was paid $14,000 a year. Asked how he accomplished this, he looked the interviewer in the eye and said, "Thrift!"

In just the same way, in the Soviet Union, roughly half the money is held by people who have 50,000 rubles or more. A very generous income is 6,000 rubles, and so one suspects that a large fraction of the people who have the most money didn't come by it honestly. The politics of selling to the people who have half the money—and presumably most of the money that would be available for large purchases—raises very serious questions.

One must first think about macroeconomic stabilization and price reform, to create a sense of what really is valuable and what really isn't. Privatization should come second. It should come through some form of gradual strategy, perhaps involving the divestiture of large numbers of companies to competing mutual funds, perhaps through setting up a pension scheme or competing pension schemes for workers that invests assets. What is surely not viable is to immediately create a big stock market, with everyone trading on a large scale. The German stock market, even today, represents 20 percent of GNP; four companies represent 60 percent of the value of the Italian stock market. It is just a myth to suppose that "people's capitalism," with everybody trading on the stock market, is necessary for capitalism to work, or is viable in the short run for what is going to happen in Eastern Europe.

WHAT ARE THE LIMITATIONS OF FOREIGN AID?

What about the role of aid? I suggest there are three problems. First, aid to governments strengthens governments, but the objective, of course, is to go in the opposite direction. However, that is not completely true. Aid to governments that helps them to enforce insider trading laws, that helps them to figure out how to sell enterprises, that sets up a safety net, is desirable aid. It is claimed, although I don't know whether the claim is true, that state enterprises in Poland
that want to get restructured and want to learn how to restructure so they can export are told they cannot get financing for Western consultants because they are not yet in the private sector. This claim is made often enough so that I believe it. It reflects a real obstacle to effective reform. Nevertheless, in general, the main effort has to be to reduce the role of government.

I refer, with some irony, to the discussion of federalism in the socialist world. Particularly in the Soviet context, there is a case for decentralization, and there is a case for strategies that promote breakup rather than unification. That is obviously difficult, when one is talking about government-to-government federal aid. However, the case for supporting decentralization rests on three arguments. The first is that new blood is more likely to succeed than old blood. For example, one wonders whether a government in Moscow with the old Ministry in charge will have the same chance of accomplishing reform that a new and—one would hope—democratic government of the Ukraine would have.

The second argument for decentralization is the competing jurisdictions argument. U.S. corporate law is great for corporations, and the reason is that there is a race to the bottom, as corporations try to locate in whatever state is maximally advantageous. If you want to promote deregulation, the republic that has the most generous foreign investment code will get the foreign investment. The republic that moves first to raise prices will get the goods and lose the rubles. The republic that has the most ambitious reform program is likely to get the most Western assistance. The dynamic of competition will tend to force everyone to move more dramatically than they otherwise would. When Estonia raised the price of liquor and Leningrad didn't, everyone with a pickup truck was in Leningrad taking the liquor back to Estonia. That produced pressure to raise prices in Leningrad. It also, it must be said, produced pressure for passport controls in Leningrad, and that is obviously much less advantageous.

The third argument for decentralization is that no one knows what the right answer is, trying multiple strategies, seeing which ones work, and then having the ones that work be emulated has something to recommend it. By avoiding a focus only on central governments, this problem can be limited.

Besides the aid limitation that relates to its government-to-government character, there is the fungibility issue. If one looks carefully at U.S. assistance to Latin America in recent years, a significant fraction of it has been recycled back to U.S. banks. U.S. banks have been indirect but significant beneficiaries of that assistance, and there is a
question as to whether that is a desirable way to spend money. If more of the assistance had been in the form of education in villages and less of the assistance in the form of cash grants to central governments, this would have been less likely.

Finally, aid as investment can accomplish very little because of the inevitably limited scale of resources.

AID AS A LEVER FOR GROWTH

Consider the money stock of the Soviet Union, not the so-called ruble “overhang.” The entire money stock of the Soviet Union, which is approximately equal to the total retail sales of the Soviet Union, is about 500 billion rubles. The black market exchange rate in the fall of 1990, which is an extreme number in this calculation, was about 20 rubles to the dollar. That means the entire money stock of the Soviet Union is only worth $25 billion. If one believes the ruble overhang is half of that—a figure that is probably on the high side—that makes the overhang $12.5 billion. If large amounts of hard currency were made available, that exchange rate would of course change. Using the tourist exchange rate, six rubles to the dollar, and at that magnitude, the money stock of the Soviet Union, retail sales in the Soviet Union, would be about $80 billion.

The point, though, is that given the scarcity of goods and the scarcity of hard currency, small amounts of hard currency, though quite large relative to people’s income, used appropriately, could have quite substantial effects. That doesn’t say whether those effects are going to deter or encourage reform. There were large amounts of hard currency flowing in, in the form of borrowing, throughout the 1970s without any substantial effect. It’s not that it is a country of 280 million people, and that $4 billion or so would make any difference. Given how important our goods are, small amounts of money could make a very large difference.

I would like to highlight two other points about aid as a lever for growth. Stabilization loans clearly are a good idea in countries that are really stabilizing, especially in the context of leading them to get rid of repressed inflation. Our conference discussion has emphasized what is probably the single most important thing we can do, namely, keep markets open. Keeping markets open will reward initiative, it will encourage foreign investment in these countries, and it will lead to their acquiring the right price structure, namely, the price structure that is available in the West. It is appropriate to think of money spent to buy political acceptability of open markets—whether it’s
displaced worker assistance in Spain or bribes of some other kind to relevant constituencies—as spending to help Eastern Europe. It may well be that spending money to buy political acceptability of open markets is one of the most important things we can do.

The other point we have neglected in our discussion of aid in the form of technical and managerial assistance is debt relief. My impression is that discussions of loans in these contexts typically make the mistake of supposing that debt will be repaid. I think this is probably not a valid assumption.

Conversely, I am a little bit skeptical of just how much is accomplished when debt that is probably not going to be paid is forgiven. Not much may be lost, but I believe it is a mistake to think that debt which countries are not repaying is in fact likely to be stifling their growth to a very substantial extent. And I think there is great danger that, unless they are carefully designed, programs directed at debt relief will not in fact flow down to average citizens in the countries on whose behalf they are crafted.

At the end of the day, the role of aid has to be relatively marginal. I think the most important things we can do are to keep markets open, provide managerial assistance in creating an appropriate infrastructure, and provide relief if things go badly wrong.
COMMENTS

Paul Marer

I would like to make three sets of points. First, what do we mean by successful, capitalist, free market systems, toward which many Central and East European countries seem to be aspiring? Second, what can be said about the strategy of introducing such a system? And third, what role is there for the West to effectively promote the transition?

BASIC FEATURES OF SUCCESSFUL MARKET ECONOMIES

In spite of many notable systemic differences between successful market economies in North America, Western Europe, and Asia, they share certain basic common features. These are:

- *Predominant private ownership of the means of production.* State-owned companies generally cannot be efficient if they are not operating in a predominantly private market economy setting. In centrally planned and transition economies, most means of production are not private. That is why privatization is essential.

- *Reasonable macroeconomic balance, which means the absence of a high rate of open or repressed inflation.* Macroeconomic imbalance is bad because it channels too much of enterprise and household activities into economically unproductive pursuits. All open and transition economies have varying degrees of repressed or open inflation. This is difficult to eliminate because in the absence of real owners and a viable banking system, traditional instruments of monetary control are not highly effective.

- *Competition.* In certain countries, domestic competition is fierce (e.g., Japan); in small economies, import competition is pervasive; in still others, both are strong. Competition is the dynamic force that causes the weak to retrench, thereby freeing resources to be employed in more productive uses. Competition also forces producers to control costs and to innovate, both essential to economic progress. Centrally planned economies (CPEs) and transition economies face little domestic or import competition. The

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former is absent not only for systemic reasons but also because production is so highly concentrated. This is why a program of deconcentration is essential. Import competition is weak or absent also for systemic reasons and, in the case of some countries, because of the precarious status of their balance of payments.

- **An adequate-to-high level of private savings and efficient financial intermediation.** CPEs and transition economies have neither; much of savings has been forced upon firms and households by the government, which is also in charge of its intermediation. In the absence of market signals, much of investment is misdirected, even if the authorities would want to use economic rather than political, social, or bureaucratic criteria to allocate it.

- **A convertible currency** is essential because it greatly expands enterprise and household choices and weakens bureaucratic resource allocation. A country cannot have a convertible currency until it allows market forces sufficient play.

- **A social safety net to help the unemployed and the physically or mentally infirm.** CPEs operate such safety nets within enterprises, in effect forcing them to act uneconomically, in the "social" interest. Safety nets have to be erected and maintained outside the enterprise sector.

In sum, during the early stages of transition, the former CPEs have none of the basic features that make market economies perform well.

**STRATEGY OF BUILDING A MARKET ECONOMY**

Because the economy is a complex and highly interdependent mechanism, all the missing elements have to be created, more or less simultaneously, even though different time periods will be needed to finish constructing the components. The best way to proceed is to introduce packages of reform and to signal a timetable for their implementation. Sequencing is really a question more of emphasis than of fundamental choice.

In the initial package, high priority should be given to weaving a social safety net (its main elements should be unemployment compensation and minimum guaranteed annual family income), together with privatizing much of small business, including much of trade. It is important that an approximate timetable be established for the reduction of subsidies and for gradually exposing producers to import and domestic competition.
WHAT ROLE FOR THE WEST?

The transformation sketched here is an extraordinarily difficult undertaking. It can be likened to demolishing a house and building a new one while its residents continue to live in it. The main difficulty is not intellectual design but political manageability in the face of:

- Having to service the kinds of huge inherited domestic and foreign debts mentioned in Steven Popper’s paper.
- Having to disturb a large array of vested economic and political interests.
- Having to tell the population that the costs of transition are immediate or near-term, while most of its benefits will be realized in the future.
- Having to put up with expectations that throwing out the communists will improve the economic situation quickly.

I agree with Olsen, Popper, and Summers that the transition should proceed with all deliberate speed. The role of the West to promote this should be twofold: First, it should assist the new governments in gaining breathing space for three to four years by helping the Central and East European countries manage the huge adverse impact on them of the collapse of the Soviet economy and the ending of the CMEA’s old institutional arrangements. Additionally, the most heavily indebted countries should have a temporary easing of their debt-service burdens. All this aid should be provided under strict conditionality, requiring that each country have a comprehensive transformation program of, say, up to five years; Western aid should be tied to progress on its implementation. Both the aid itself and the conditionality in particular would help governments manage the domestic politics of a difficult transition program. Second, the West should provide all kinds of technical assistance and training, along the lines discussed in the papers and comments by Juster, Adelman, and Van Oudenaren.
COMMENTS

C. Richard Neu

In listening to the conference discussions, I have been struck by the depth of the thinking that has been reflected here. One speaker after another has pointed to the fundamental issues that have to be resolved in designing development strategies for Eastern Europe: How fast can or should privatization proceed? Is microeconomic reform possible before macroeconomic stabilization has been accomplished? Which among the many needs of the East European economies should be given priority in aid programs? Should aid be seen as a necessary precursor to economic reform, providing East European governments with enough slack to institute potentially painful reforms, or should it be seen as a reward, provided only after recipient governments have demonstrated their willingness to make hard choices?

These are important questions, and it is useful for the academic and policy communities represented here to debate them. We have not resolved them, but I think we have made some progress. At the very least, we have a clearer idea of the lines of research and deliberation that will form the basis for the continuing inquiry these questions deserve. In this respect, I think that this conference has been a success.

I cannot escape the feeling, though, that we have left part of our agenda uncompleted. These fundamental questions will not be resolved soon. This, of course, should not deter us from pursuing them. In the meantime, though, there are real needs to be met in Eastern Europe. The U.S. government and the governments of other potential donor countries have to plan today for aid programs that will be implemented tomorrow. This planning cannot and should not wait until we have thoroughly studied the pros and cons of a variety of aid strategies. One of our purposes in this conference, as I understand it, is to offer advice to USAID about how to manage aid programs for Eastern Europe in the very near term. I fear that we may not have provided as much useful advice on this score as we might.

To try to fill this gap, I will propose some interim operational guidelines for planning U.S. aid to Eastern Europe. I do not suggest that these guidelines are in any sense complete or final. I do not even suggest that they are completely correct. It is clear that encouraging
the rise of market economies is a very complex business, and no simple set of dos and don'ts will be sufficient for all contingencies.

Nonetheless, I think a few simple rules may carry us a long way. As several speakers have pointed out, the needs of Eastern Europe are enormous and the resources that the United States or any other donor country can provide are small by comparison. This suggests to me that no donor is going to have to make subtle choices about how best to allocate available aid resources. For the foreseeable future, there will be many more obviously worthwhile projects to undertake than resources are available for. Some will certainly provide higher rates of return than others. But since we have the resources to meet only the most pressing needs, it seems to me that there is little to be gained from attempts to fine-tune our aid programs.

It is not the job of Western donor nations to reform and develop the economies of Eastern Europe. This, necessarily, is the job of the East European governments themselves. Our role is to assist in this process to the degree that we can. Thus, our aid programs do not need to be in any way balanced or comprehensive. As long as we are doing good and are seen to be doing good, we should probably not worry overly much if some alternative strategy might do marginally more good. Rough guidelines will probably be all we need in the near term.

In this spirit, I propose the following four rules of thumb for planning U.S. aid to Eastern Europe.

1. **Except for humanitarian purposes, do not support consumption.**
   The need for new investment in Eastern Europe is very large. This investment will take place only if local and foreign entrepreneurs see opportunities to earn rates of return sufficient to outweigh the considerable risks that investors in Eastern Europe will face for the next few years. Fortunately, unmet demand is high in Eastern Europe, and the marginal product of additional capital will also be generally high. Almost by definition, foreign aid that subsidizes consumption will contribute nothing in the form of additions to the capital stock. Worse, though, subsidies for consumption will reduce the prices of final outputs, depress expected rates of return on new and existing capital, and discourage investment.

The political consequences of subsidizing consumption are also problematic. The process of economic reform will be painful throughout Eastern Europe, and governments will need strong incentives to continue to pursue painful policies. The principal motivating force for the reform that has been accomplished to date has been consumer dissatisfaction over living standards. For foreign donors to ease the
plight of consumers would be to weaken the principal force driving governments toward reform and therefore counterproductive.

Perhaps the most important practical implication of this rule of thumb is that food aid to Eastern Europe should be viewed with deep suspicion. The most likely consequences of such assistance will be reduced investment in food production and distribution and reduced pressure on governments to get on with the task of reform. Food aid in the event of a serious crisis, of course, is easily justified on humanitarian and political grounds. But aid intended simply to hold down the cost of food in Eastern Europe is likely to do more harm than good.

2. **Choose aid projects that are both safe and visible.** Aid should be aimed at providing material assistance to the people of Eastern Europe. It should also, though, serve to demonstrate both the good will of Western donor nations and the advantages to be gained from adopting Western practices and techniques. Thus, it is important that Western aid should generate clear and visible benefits.

To be sure, much of what needs to be accomplished in Eastern Europe will require risky undertakings. Much of the social, financial, and economic infrastructure that has to be built will produce little immediate visible payout. But as we have noted above, the goal of Western aid is not and cannot be to undertake every project necessary to rebuild the East European economies; most of what needs to be done will have to be done by the East Europeans themselves. Inasmuch as foreign donors will be supporting only a few of the many necessary projects, there seems little need for them to support projects with invisible or highly uncertain benefits. The number of worthwhile, safe, and visible projects will far exceed what foreign donors can support; why, then, support any other kind?

As a practical matter, this means that foreign donors should concentrate on relatively simple, small-scale efforts where the need is clear and where immediate benefits for the population are likely. Examples of such projects might be sewage treatment facilities or road building. To be avoided are very large-scale projects that depend for success on the successful completion of other large-scale projects or on the enactment of economic or political reforms beyond the control of project managers. Among the kind of projects to be avoided, perhaps, are such things as trying to rebuild an entire national telephone system and large-scale civil engineering works like dams, bridges, or tunnels.
3. Do not intensify already functioning competition. A major aim of economic reform will be to foster competition among domestic suppliers in most sectors of the economy. In the early phases of reform, this competition may be rather fragile. New firms—some locally owned and some owned by foreigners—will be setting up where previously there had been only state monopolies. If foreign governments intervene, through their aid programs, in markets where even a rudimentary level of indigenous competition has grown up or appears likely to, they run the risk of driving new and vulnerable firms out of business, leaving nothing but the still-monopolistic remnant of the old state monopoly when the aid program ends. Starting new businesses in Eastern Europe will be difficult enough without having to compete—even indirectly—with the aid agency of some foreign government.

A much better course, it would seem, is to concentrate aid efforts in activities where internal competition is unlikely or undesirable. This suggests a concentration on public service- and public utility-like functions such as water and sewage systems, power distribution systems, payments and check-clearing systems, health clinics, education, etc. If aid projects succeed in establishing commercially viable operations, these can eventually be turned over to either public or private entities to be operated as regulated monopolies. If these services are “natural” monopolies, few opportunities for fruitful competition will have been lost. Also attractive for these reasons are aid projects aimed at assisting municipal or regional governments in providing public services.

This line of reasoning leads me to question some kinds of proposed aid projects that are widely seen as attractive. We are often told, for example, that there is a huge unmet demand in Eastern Europe for Western books. The idea of supplying a commodity as wholesome, inspiring, and flattering to the West as the best of our cultural and technical writings at first seems very appealing. But publishing is not a technically demanding endeavor. Surely there are or could be a number of firms in Eastern Europe capable of publishing or distributing Western-style books. By supplying much-demanded books as part of an aid program, though, we may discourage the establishment of local publishers and distributors, thereby perpetuating the problem our aid is aimed at overcoming.

For some products, though, there may be little prospect that a meaningfully competitive local industry will ever be established. Private East European pharmaceutical firms, for example, will undoubtedly appear, but it seems extremely unlikely that these firms can ever be-
come efficient producers of more than a limited range of products. Economies of scale are extremely important in the pharmaceutical industry, and the efficient production of many drugs can be managed only on a continental scale. Aid programs to supply selected drugs to East European physicians and hospitals, therefore, might prove to be highly effective. Considerable benefits may accrue to local populations with little adverse affect on the local pharmaceutical industry, which probably would not have developed anyway.

4. Remove physical and institutional barriers to competition. The logical counterpart to the previous rule of thumb is that aid should be aimed at removing existing barriers to competition. If, for example, inadequate transportation systems make it difficult to ship fresh produce, agricultural markets may become a series of local monopolies. Road building, railroad upgrading, and provision of refrigerated trucks or rail cars might all help to foster competition on a regional or national scale. Similarly, an inadequate network of financial services—banking, insurance, accountancy, and so on—may discourage the creation of new businesses. Training and technical assistance programs to modernize financial services and perhaps aid in purchasing data processing equipment could remove some of these barriers to entry and encourage the more rapid growth of competition. Particularly valuable may be business training and consulting services, which may facilitate the creation of new enterprises and thus increased competition.

Adherence to these guidelines, I think, will increase the odds that Western aid to Eastern Europe will achieve at least a Hippocratic standard. That is, aid will do no harm. This, in itself, would be something of an achievement. I think, though, that we might hope for more than this. Aid planned in accordance with these guidelines is likely to generate important benefits for the people of Eastern Europe. By contributing visibly to the development of stable, market-oriented economies in Eastern Europe, such aid will also serve to advance the longer-term interests of the United States.
PART IV

ONGOING U.S. GOVERNMENT
ASSISTANCE TO CENTRAL
AND EASTERN EUROPE
10. AN OVERVIEW OF U.S. GOVERNMENT ASSISTANCE TO CENTRAL AND EASTERN EUROPE

Kenneth I. Juster

During the past year we have witnessed the most dramatic changes on the European continent since the end of World War II. The turn away from communism and the emergence of democracies in Eastern Europe represent nothing less than a vindication of U.S. foreign policy during the postwar era. But we also must appreciate the fact that the communists drove the countries of Eastern Europe and their economies to the brink of ruin. They have left behind in these countries an obsolescent industrial base, massive debt, and environmental decay. Perhaps the most damaging legacy, however, is psychological: populations grown accustomed to risk avoidance, an atrophying of entrepreneurial skills, and a dependence on government largess (including price subsidies, guaranteed jobs, and rent control). Thus, the new governments of Central and Eastern Europe have their work cut out for them. And so does the West—because it is in our interest that they succeed.

For the United States, a successful transition to democracy and free markets in Eastern Europe would mean at least two important things for our interests. First, it would mean that the turn away from communism has become irreversible. Second, it would help ensure that the region will attain some stability and not once again become a power vacuum or an unstable theater of tension and rivalries. We therefore have every incentive to assist the Central and Eastern European nations in their time of need—and we are doing just that.

GENERAL FRAMEWORK FOR U.S. ASSISTANCE

I have found in my discussions with those outside the government that the Administration’s approach to Central and Eastern Europe is often insufficiently understood or appreciated. The fact of the matter is that the Administration does have a philosophy and a strategy for promoting reform throughout that region. However, we do not—and, I would submit, we cannot—have a finely tuned blueprint to antici-
pate specific developments in each particular country. The era of blueprints is behind us; its graveyard was Eastern Europe in 1989. Anyone who had a blueprint for the region over the past year would have had to change it numerous times by now. What we need, instead, is a clear sense of what our destination ought to be, and a good road map for getting there. This, I believe, we have. Beyond that, we must be flexible—and sufficiently skillful—to respond to events as they occur.

So what is our assistance policy in Central and Eastern Europe? It is based on the concept of a "new democratic differentiation." This term was chosen to contrast with our longstanding policy of expanding contact with communist governments in Eastern Europe to the extent that their foreign policies differed from that of the Soviet Union. We now have adopted a new policy standard—that is, the United States will tailor its assistance to the specific needs of each East European country as it moves positively toward four objectives:

- First, progress toward political pluralism, based on free and fair elections and an end to the monopoly of the communist party.
- Second, progress toward economic reform, based on the emergence of a market-oriented economy with a substantial private sector.
- Third, enhanced respect for internationally recognized human rights, including the right to emigrate and to speak and travel freely.
- And fourth, a willingness on the part of each of these countries to build a friendly relationship with the United States.

In practice, the "new democratic differentiation" distinguishes three levels of assistance to Central and East European countries. I will briefly describe these three levels of assistance and provide some examples of the types of programs we are supporting.

At the most basic level, some countries need short-term humanitarian aid to cope with severe shortages of necessities, such as food and medicine. The United States has made humanitarian assistance available to all countries of the region. For example, we have provided medical supplies to the Romanians, and food relief totaling approximately $200 million to both Poland and Romania in their time of urgent need. Also during this fiscal year, the Department of Defense, through its humanitarian assistance program, has provided surplus equipment to Hungary, Romania, Poland, and Bulgaria.
Over the medium term, there are a number of steps that the United States is taking to create an institutional framework to support political reform and the move toward market economies. Again, most of this assistance is open to all countries of the region, but in proportion to their commitment to reform. There are four general categories of assistance here, and different priorities within each for each country.

One of our priorities is to assist in developing democratic institutions and the rule of law. That assistance from the outside can help to establish democracy is proved by the examples of West Germany and Japan. For both historical and policy reasons, the United States enjoys a comparative advantage over other Western countries as the predominant source of government-supported assistance to build democratic institutions. Moreover, we view our support for democratic initiatives as advancing our own interests in the region. Our initiatives in this area are concentrated in four areas:

- **Rule of law and human rights.** The United States will assist democratic governments of Central and Eastern Europe to establish laws and legal systems based on the rule of the majority and protection of the rights of individuals and minorities.

- **Political process.** The United States will help new legislatures, political parties, and civic organizations develop into effective, stable democratic institutions.

- **Social process and cultural pluralism.** Through, among other things, support for educational curriculum reform, training of teachers, and support for trade unions and other nongovernmental organizations, the United States will assist in strengthening the principles and practices of democratic pluralism within the societies of Central and Eastern Europe.

- **Support for independent media.** The United States will assist in establishing independent radio and television stations, publishing independent newspapers, and training journalists. Indeed, we have already launched an Independent Media Fund designed to advance these programs on a regional basis.

A second medium-term priority is technical training and assistance in support of economic reform. Our priorities here include, for example:

- Assistance in designing comprehensive economic reform policies, both in the macroeconomic and microeconomic areas. We have had extensive consultations with several of the East European governments on monetary policy, budget policy, and exchange rate convertibility, as well as on price reform, privatization, and competition policy.
• Assistance in restructuring state-owned enterprises and preparing them for privatization.

• Assistance aimed at developing an institutional infrastructure conducive to a market-based economy, with emphasis on banking and financial services, a securities exchange, new tax codes, and generally accepted accounting practices.

• Assistance to develop legal frameworks for private, market-based economies.

• Training of managers, accountants, and others in the basic workings of a market economy.

• English language training, which will facilitate the exchange of scientific and technical information.

Based on the suggestions that the United States has received from the various East European governments, as well as from our embassies in the region, we are focusing this assistance most heavily in the areas of agriculture, banking, energy, health care, housing, small business, and public administration.

I have left aside the environment, because that is a separate medium-term assistance priority in and of itself. The primary goal of U.S. environmental assistance programs in Eastern Europe is to strengthen the region’s capacity for (1) mitigation of critical environmental problems and (2) remediation and prevention of pollution through the setting of new environmental standards and regulations, perhaps on a regional basis, that are compatible with economic growth. We also seek to maximize the rapid introduction of cost-effective energy conservation technologies in Central and Eastern Europe to bring about environmental improvements while lowering the cost and capital requirements for fossil fuel consumption.

Finally, though not strictly within the assistance framework, the U.S. government seeks to increase market access by normalizing bilateral trade and investment relations with countries that meet the requirements of U.S. law. Our efforts in this area include:

• The signing of Bilateral Investment Treaties.
  – We have already concluded a Comprehensive Business and Economic Agreement with Poland.
  – We are in the final stages of concluding a Bilateral Investment Treaty with Czechoslovakia.
  – We are in the midst of negotiations with Yugoslavia on a Bilateral Investment Treaty.
- We are in the process of opening negotiations for such agreements with Hungary and Bulgaria.

- The signing of Trade Agreements and the granting of most-favored-nation (MFN) status.
  - We have already granted MFN to Poland, Hungary, and Yugoslavia.
  - We have signed a Trade Agreement with Czechoslovakia, which will grant MFN once approved by the Congress.
  - We are beginning the process of negotiating the Trade Agreement necessary for such status with Bulgaria.

- This category of assistance also includes the programs of the Export-Import Bank (now operating in Poland, Hungary, Yugoslavia, and Czechoslovakia), the Overseas Private Investment Corporation (operating in Poland, Hungary, and Yugoslavia, and opening in Czechoslovakia in the near future), and the Trade and Development Program (operating in Poland, Hungary, and Czechoslovakia), which provides U.S. government money to foreign governments for feasibility studies by U.S. firms.

- Increased access of the East European countries to high technology from the West. Indeed, in response to developments in Central and Eastern Europe, COCOM recently liberalized controls on the export of technology to that region.

All of these agreements and activities are designed to stimulate the economies of Eastern Europe and, as such, to improve the quality of life.

The third and final level of assistance is bilateral and multilateral economic support and other measures designed to permit the integration of the countries of Central and Eastern Europe into the world economic community. This is by far the largest category of funding and is available, generally with a good deal of conditionality, for those countries which have decided to take the "leap" to a market-based economy by implementing major economic reform programs. Poland is clearly in this category, followed by Yugoslavia, with Hungary and Czechoslovakia not far behind them. U.S. economic support here is in several forms.

On the multilateral front, the United States is the major contributor (almost 20 percent) to the IMF stabilization programs and IBRD structural adjustment programs in these countries. Again, these two institutions are most active in Poland, but have programs in Hungary and Yugoslavia as well. Czechoslovakia has just become a member of
the IMF and the IBRD, and Bulgaria is currently in the process of seeking membership in these institutions. The United States is also one of the founding members of, and will be the largest contributor (10 percent) to, the new European Bank for Reconstruction and Development. At least 60 percent of the EBRD's loans are to be devoted to private sector projects—to set up new enterprises or fund the privatization of state-owned enterprises. No more than 40 percent of the EBRD's loans will be for infrastructure improvements for state-owned enterprises that also should help nurture free enterprise—such as improved telephone systems and railways.

The United States has also taken the lead in establishing the new OECD Center for Cooperation with European Economies in Transition, and has proposed, in addition, that the OECD offer a new affiliate status at this time for Poland, Hungary, and Czechoslovakia. Yugoslavia has long been an associate member of the OECD.

In terms of bilateral economic support, the United States led the way, with a $200 million grant, in establishing a $1 billion stabilization fund to support the convertibility of the Polish currency. In addition, one of our most significant initiatives has been the establishment of the Polish-American and Hungarian-American Enterprise Funds.

The Enterprise Funds are a bold experiment in a new way of delivering economic assistance. Rather than have the U.S. government provide a one-time grant to Poland or Hungary, we have developed instead the Enterprise Funds as a means for tapping into private sector expertise to manage U.S. government grants. The president, in consultation with the Congress, has asked a group of prominent private citizens from the United States, and from Poland and Hungary for each of the two Funds, respectively, to form a corporation to use U.S. government money to make loans, grants, equity investments, and other forms of financial transactions designed to promote private sector development in Poland and Hungary. The hope is that these Enterprise Funds will be able to manage the U.S. government grants in the way that an investment banker might do—unencumbered by the bureaucratic constraints normally associated with government activities—and that they will be able to multiply many times over the financial impact of the initial grants.

GUIDING PRINCIPLES

Before turning to a brief discussion of the SEED Act and some of the programs the United States is administering in Eastern Europe, I
would like to note some of the general principles that we have developed to guide our activities.

- Use assistance to advance the process of economic reform, not substitute for it.
- Emphasize projects that can start up fast and have an immediate impact to meet urgent needs.
- Concentrate assistance in each country in a limited number of areas, where the United States has a comparative advantage over other Western donors and where the United States can have an impact.
- Concentrate on practical, nuts-and-bolts programs rather than abstract theory or study.
- Encourage demonstration projects in key sectors of the economy, especially projects designed to improve the environment and the quality of life.
- Establish, where practical, generic programs which can then be tailored to the needs of each country.
- Put experts in the field for periods of up to one year; stay away from short visits or one-day programs.
- Emphasize training in the recipient countries rather than in the United States, for reasons of both cost-effectiveness and avoidance of a brain drain of valuable but limited talent.
- Emphasize educating the educators and training the trainers.
- Work with existing institutions, if possible. Generally avoid creating new institutions because the overall costs and the time lag are too great.
- Establish sustainable relationships between U.S. institutions and organizations in Central and Eastern Europe, so as to strengthen the American presence (and influence) in the region.
- Support programs which respond to the needs of the Central and East Europeans rather than those which are designed to suit the desires of U.S. organizations.
- Develop a streamlined funding mechanism to gain maximum flexibility while maintaining accountability.
- Before starting a new project, take into account the activities of other Western countries and of the international financial institutions. Coordinate efforts where possible.
U.S. ASSISTANCE PROGRAMS

So how do the framework and the principles that I have mentioned apply in terms of U.S. government assistance programs in Central and Eastern Europe? I think it is fair to say that four countries qualify now for special attention because of their readiness to implement democratic reforms and their decision to make the transition to a market-based economy. These are Poland, Hungary, Czechoslovakia, and Yugoslavia. Of these four, we believe that Poland deserves top priority for several reasons:

- Its economic problems are the most severe.
- Its economic reforms are the most far-reaching.
- Its economy is the largest in the region.
- Poland is viewed by most observers as the “test case” in Eastern Europe. Success or failure of the Polish effort, therefore, is extremely important politically.

Yugoslavia, under Prime Minister Markovic, has also embarked on an ambitious program of economic reform, and two of the republics—Slovenia and Croatia—have recently held free elections. The United States has provided substantial technical assistance to Yugoslavia, but we are concerned about the rising internal tensions in the country and the detrimental effect these tensions could have on further political and economic reform.

Hungary and Czechoslovakia have both elected new democratic governments this year, and while each country is moving toward a market-oriented economy, each also has yet to define clearly a comprehensive economic reform program.

With respect to Bulgaria, the U.S. government has expressed its concern about the fairness of the elections in June 1990, but we are cautiously optimistic about the new government just formed there. Assuming continued democratization, the United States is prepared to offer assistance.

Finally, on Romania the United States continues to have reservations about the commitment there to democratic reform and basic human rights. We have informed the Iliescu regime of the sorts of democratic reforms we would like to see, and we are prepared to assist the Romanians in building democratic institutions.

As to specific programs in the region, the focus has been primarily on Poland and Hungary because those are the countries for whom the Congress appropriated money. The initial legislation in this area—
the Support for East European Democracy (SEED) Act of 1989—was written prior to the revolutions in Bulgaria, Czechoslovakia, Romania, and East Germany. The SEED Act, therefore, was designed to promote reform in the two most liberalized countries in the region at the time—Poland and Hungary. Moreover, because at the time of the drafting of the SEED Act we were not yet dealing with popularly elected governments in those two countries, the act designated virtually all of the funds appropriated to be used for specific programs.

Listed below is a quick review of the programs provided by the SEED Act and the amounts appropriated for fiscal year 1990.

- **Humanitarian assistance:**
  - Food assistance for Poland (over $130 million).
  - Medical supplies for Poland ($2 million).
- **Democratic initiatives for Poland and Hungary ($4 million).**
- **Developing human resources for Poland and Hungary:**
  - Technical training ($3 million).
  - Labor market transition ($1.5 million).
  - Peace Corps ($2 million).
  - Educational/cultural exchanges ($3 million).
  - Scholarship programs ($2 million).
  - Science and technology exchanges ($1.5 million).
- **Environmental initiatives:**
  - Clean fossil fuels (Poland) ($10 million).
  - Krakow environmental activities ($2.3 million).
  - Regional Environmental Center ($1 million).
- **Trade and Investment:**
  - OPIC authority to operate in Poland and Hungary with $40 million of OPIC's Investment Guarantee Authority earmarked for Poland.
  - Export-Import Bank authority to guarantee, insure, finance, extend credit, and participate in extension of credit in Poland and Hungary.
  - Trade Credit Insurance Program: $200 million in secondary guarantees of short-term Ex-Im trade credits for exports for the private sector in Poland.
- Trade and Development Program: $2 million for financing planning services of U.S. private sector for important development projects.

- Stabilization Fund for Poland ($200 million grant).
- Enterprise Funds:
  - Poland ($35 million).
  - Hungary ($5 million).

While the SEED Act provided authority for the expenditure of funds only in Poland and Hungary, there has been to date some limited authority for expenditures in the other East European countries. First, when the Congress passed the Panama Act to provide emergency assistance to the new government in that country, it added authority for the expenditure of $10 million for democratic initiatives in Central and Eastern Europe. These funds have been used for pre-election assistance, development of an independent media fund, and the launching of rule of law programs, among other things.

Second, various U.S. government agencies—such as the Commerce Department, AID, USIA, and the Peace Corps—have utilized existing budgetary authority or presidential waivers for additional programs in Central and Eastern Europe.

The Administration also introduced new legislation on March 7, entitled the "Eastern European Democracy and Free Market Act of 1990," to respond to the dramatic events in that region. The president's initiative, in effect, seeks to enact the general framework for assistance that I have described above. It makes all the countries of Central and Eastern Europe, as well as Yugoslavia, eligible for assistance at a level corresponding to their positive movement toward U.S. objectives for the region. It requests $300 million for fiscal year 1991 for the funding of assistance programs. And it contains no earmarks, so as to provide the Administration the necessary flexibility to coordinate assistance based on developments in the region, the cooperative international effort, and requests from the recipient countries.

The Congress has not yet passed such legislation, with the Senate Foreign Relations Committee and House Foreign Affairs Committee each having its own version of an assistance bill for Eastern Europe. We remain hopeful that in the next few weeks there will, at least, be an appropriation of new funds along with necessary authority to operate—with the needed flexibility—throughout the region.
THE INTERNATIONAL EFFORT

It should be apparent that the U.S. strategy has deliberately been to avoid pumping money willy-nilly into the region. The reason for this is that despite the calls for some kind of new "Marshall Plan" for Eastern Europe, the needs of the region today are substantially different from those of Western Europe in 1947.

Then, we had to rebuild a region physically devastated by war but nevertheless generally possessing the entrepreneurial know-how, economic infrastructure, and democratic institutions necessary for a quick recovery. As I have noted, in Central and Eastern Europe today, those skills and institutions are to one degree or another lacking. That is why, in addition to the financial assistance we are providing to back meaningful stabilization and structural adjustment programs, we are seeking to transfer a wide range of technical assistance so that these countries will become equipped to absorb Western investment and aid. Simply throwing money at the region, even lots of it, without relating it to progress toward structural reforms may—as happened in the 1970s—only postpone the advent of change and squander our assistance efforts.

There are a few additional points I would make in response to those who are saying we are not doing enough. First, in large part because of U.S. efforts, we now have powerful and prosperous European allies who can share with us the burden and responsibility of helping to rebuild the other half of their continent. Indeed, President Bush was instrumental in establishing the Group of 24 Western governments that has already coordinated approximately $14 billion in grants, credits, guarantees, and technical assistance for Poland and Hungary.

The G-24 is designed to harness the concerted efforts of the West to support political and economic reform in Eastern Europe. The European Commission serves as the Secretariat to the G-24. Its functions include the following:

- Coordinate the bilateral assistance programs of the donor countries.
- Serve as an information clearinghouse to exchange information and avoid duplication of effort.
- Conduct needs assessments and set indicative priorities for the East European countries.
- Help implement initiatives and joint projects, such as the Polish stabilization fund and the regional environmental project in Budapest.
The G-24 has agreed on criteria for eligibility for its coordinated assistance that are similar to those adopted by the United States. These criteria are progress toward the rule of law, respect for human rights, the introduction of multiparty systems, the holding of free and fair elections, and the development of market-oriented economies. The G-24 has also established working groups on (1) food aid, (2) investment, (3) training, and (4) the environment. The group on food aid was especially successful in coordinating emergency agricultural assistance to Poland.

Finally, I think it needs to be said that when one looks at the actual budgetary outlays for assistance to Eastern Europe—as opposed to credits, insurance, and guarantees which make up the assistance programs of many of our partners—the United States is right at the top of the list of donor countries.

THE ADMINISTRATION OF U.S. ASSISTANCE

The fact of the matter is that what we are doing in Eastern Europe is something that has never been tried or accomplished before—that is, managing the rapid transition of centralized command economies into free market systems, and totalitarian regimes into democratic states under the rule of law. As a result, we as well as our friends and partners in Eastern and Western Europe have been feeling our way as we go. It is a new experience for all of us. It is a dynamic process, with continually changing demands and requirements. We have made some mistakes along the way: committing too many resources here, too few there, duplicating efforts unnecessarily, and not always coordinating among ourselves as best we might.

We are still at a very early stage—an experimental stage—in our efforts to bring Eastern Europe out of a 50-year time warp. Although what we have accomplished thus far may seem prosaic in light of the enormous task ahead of us, we are off to an excellent start. We cannot solve the manifold and diverse problems of transition to market economies in Eastern Europe in one fell swoop, but I believe that we have the right strategy to do so over time.

I would like to comment for a moment on the task of coordinating U.S. assistance to Eastern Europe. I am referring in the first instance to the issue of coordination within the U.S. government. Over 25 U.S. government agencies have become involved in providing assistance of one form or another to the countries of Central and Eastern Europe. Some of these agencies are normally engaged in foreign affairs and are therefore familiar with operating in the inter-
national environment. In many cases, however, domestic agencies are seeking to become involved in the assistance process. These agencies have an important role to play, but coordinating among them has been a difficult task, especially when all agencies are competing for scarce resources. I suspect our West European counterparts have had similar experiences.

It is even more difficult to coordinate private sector activities, which include for-profit ventures, proposals for technical assistance that require government funding, and volunteer efforts. With regard to for-profit ventures, we can—and do—provide guidance and encouragement because such ventures are critical to successful reform in Central and Eastern Europe. But it is not the government's role to subsidize or favor one business venture over another.

As to private sector groups seeking government funding, this is in many instances the most difficult category with which we deal. Both we and the governments of Central and Eastern Europe have been overrun by a vast array of private sector proposals to provide technical assistance and the like, proposals that vary significantly in quality. We have to find ways to sort out the good from the bad.

Finally, voluntary assistance represents a great untapped potential. We are now seeking to organize voluntary activities in the United States through the president's recently announced Citizens Democracy Corps. We plan to develop a clearinghouse that will provide an inventory of the technical skills and services that the U.S. private sector can provide. We will then be able to match these skills and services with needs of the Central and East European countries.

In recognizing the difficulties of coordinating U.S. government and private assistance activities, I should note one fact about which we should not be ashamed. Free market economies, such as ours, are not completely compatible with the provision of coordinated assistance. The very virtue that we are trying to promote in Eastern Europe—a private sector with a free market orientation—is what has led a multitude of different groups, both within and outside the government, to compete for scarce resources. We must wrestle with these problems and seek to give as much guidance as we can to the assistance process, providing policy priorities and leadership on major initiatives. In the end, however, we cannot rigidly control the process.

All of these problems of national coordination have sometimes led us to think—mistakenly—that international coordination is virtually impossible. Certainly, it is a formidable task for the G-24 to coordinate the provision of assistance. The simple fact of the matter is that
you cannot tell the domestic constituency in one country that, for example, it should participate in agricultural programs but not in environmental ones. Each donor country has a full range of interest groups that want to be involved in Central and Eastern Europe, and though it may be desirable, it is just not practicable always to divide up areas of responsibility. But we should make sure, at least, that our assistance efforts are additive in value. In this regard, the United States has played a key role in launching joint projects, such as the Regional Environmental Center in Budapest, in which others have joined.

One other important point to note is the need for coordination in-country by the recipients of our assistance. As new governments are formed in the region, they must develop their own sets of priorities, so that they can provide greater specificity of direction for the donor countries. In doing so, we also encourage the new governments of Central and Eastern Europe to increase the degree of dialogue and cooperation among them, and even to consider approaching some of their problems—such as energy efficiency—on a regional basis.

THE ROLE OF THE PRIVATE SECTOR

I am convinced that we must accord a high priority to the role of the American private sector in the transformation and recovery of the Central and East European economies. Western public sector money alone is not going to be the answer to the needs of the East Europeans today. In the long run, it is through American and Western private sector investment that the region will obtain the amounts of capital needed to create jobs and self-sustaining economic growth.

Clearly, the involvement of the private sector is not simply a matter of government exhortation or a sense of charity or adventure by U.S. businessmen. It goes without saying that American companies will have to be satisfied that the mix of risk and return is competitive with opportunities elsewhere. I can assure you that the U.S. government is doing everything it can to make Central and Eastern Europe a level playing field and an attractive place for American investment.

In my view, American investors will enjoy certain intangible advantages over much of the competition. The fact is that we have great friends in the emerging democracies. They remember us for not ever having wavered or compromised in our support for their freedom and independence, and they have absolutely no qualms about our being present on the ground as active participants in the economic and political regeneration of their societies. But if Americans wait until the
situation fully stabilizes in Central and Eastern Europe, we will find the region already overcrowded with Western Europeans and Japanese.

CONCLUSION

The task ahead for the East Europeans will not be an easy one. The crisis in the Persian Gulf highlights some of their energy problems; the expected Soviet conversion to hard currency trade based on market prices this January will bring further problems. Moreover, we are now seeing new regimes learning that it was easier to unite in opposition to the communists than it is to develop the political skills necessary to govern under democratic conditions.

We must be patient and realistic. We must acknowledge that reform is going to be a lengthy and painful process. In the final analysis, success depends on the democratically elected governments of the region. But Western assistance can make a difference. And if we do it right, we will have created a model for the transition in Central and Eastern Europe that can be applied to transitions we face elsewhere today, such as in the Soviet Union, and to transitions we will surely face tomorrow.
11. AID PROGRAMS IN CENTRAL AND EASTERN EUROPE

Carol Adelman

This is an exciting time to be working in the field of development assistance. Economic and political freedom are on the march on every continent, but the world's spotlight is focused on Eastern Europe. While political science has sometimes been called the "Queen Bee" of the social sciences, today economics sits on the throne. It remains to be seen if the leaders of Eastern Europe can exhibit the same skill in the realm of economics that they have shown in the political arena.

The program can be depicted generally by three characteristics:

• There are no models for transforming communist countries into capitalist countries. While the world's libraries are full of books on how capitalist countries became Marxist, there are no books on how to reverse the process. We are therefore providing a wide range of assistance in the areas of legal and regulatory reform as well as privatization, business development, banking, and capital markets.

• Events are happening so quickly that one idea or effort can be outdated or overtaken by events within the week. This creates great challenges for government bureaucracies and intergovernmental coordination, which are more ponderous and cautious in approach.

• The most basic types of assistance are needed. Essential economic and political reforms such as laws on private property and decentralized control are very important. Frequently, donors' regulations and stipulations are limiting and not helpful to the recipient countries, particularly if the bulk of the aid is in the form of credit tied to the donors' products. This is the case with most of the Western European aid programs. Thus, the United States is able to provide valuable assistance in a rapid and direct response to help ministries or the private sector with essential supplies such as medicines, paper, faxes, and other equipment.

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In discussing the U.S. government foreign assistance program for Eastern Europe—the modus operandi and the implications for development assistance in general—the most striking feature of the assistance effort is the high degree of interagency coordination involved. The entire effort is guided by Deputy Secretary of State Lawrence Eagleburger as the chairman of the Coordinating Committee for Aid to Eastern Europe. The Agency for International Development works as the executor or implementer for the policy decisions of the Coordinating Committee.

This coordination, and the conduct of the assistance program more generally, is, we believe, benefiting substantially from lessons learned in the conduct of past assistance programs. Among some of the most important lessons are the following:

1. These programs have been designed to reward countries by providing assistance after they have undertaken free and fair elections and implemented sufficient economic reforms. Secretary of State Baker has said that our support is to be measured by a single test: whether it advances democracy and economic liberty. Thus, we are moving ahead with programs in Poland, Hungary, and Czechoslovakia. We have limited our assistance in the other countries to humanitarian aid and modest economic technical cooperation until the complete criteria have been met.

2. The projects are regional rather than country-specific. Thus, there are no “entitlements” or expected annual dollar amounts for any one country. Instead, the assistance program is viewed as a regional one from which a country can draw upon various sources of technical assistance, training, and some commodities. The projects can thereby provide incentives for countries to continue economic and political reforms; this is in contrast to a frequent attitude among some traditional AID recipients that their foreign aid will be forthcoming regardless of their behavior.

3. The foreign aid extended is explicitly intended to be temporary or transitional. The aid should be a catalyst to the private investment and trade flows that are the desired goal of foreign assistance. Indeed, the leaders of Eastern Europe discuss foreign aid in this context, and we too expect to see these countries “graduate” during our tenure or shortly thereafter.

4. In contrast to generally negative attitudes in the United States about foreign aid, Eastern Europe has a strong and active domestic political constituency. Therefore, the program is more visible and must be more responsive to the interests and demands of these con-
stituencies. This implies concrete “deliverables” with minimum research and studies. The strong domestic interest enables us to draw upon the services and skills of Americans from Eastern Europe as well as to better leverage assistance from the private sector.

5. These programs are intended to embody and espouse U.S. political values of capitalism, democracy, political pluralism, and human rights. While these values and programs have always been a part of our foreign policy and assistance efforts, the current approach is more coherent and assertive. As a bilateral donor, the United States has an important role to play in the development of political institutions such as elections, parliaments, judicial branches, and the nongovernment sector.

6. SEED programs emphasize technical assistance and training rather than large-scale cash transfers, equipment, or commodities. This is essentially a function of the type of program outlined above, that is, one that promotes institutional development. Moreover, the funds available are not sufficient for financing larger-scale programs.

7. A concerted effort is under way to streamline the entire delivery of assistance under this program. One aspect of this is to place the locus of program management and financial controls in Washington, with oversight and monitoring conducted through frequent visits and communications. Thus there will not be large AID missions in East European capitals, but rather a minimal presence with the bulk of personnel in Washington. The entire AID project design and contracting system has been “debureaucratized” to have a faster turnaround time, less red tape, and more project responsibility and accountability with the actual team leaders in charge.

These are just some of the new approaches being applied to our assistance program in Eastern Europe. They reflect years of knowledge and experience in both correct and incorrect ways of executing programs. To be sure, the excitement and interest in working on aid to Eastern Europe has enabled us to recruit excellent staff. The increased emphasis on results through increased management responsibility, along with visibility and rapidity, has also served to generate a high degree of interest and enthusiasm for working on this program. The experience of frequent and in-depth interaction with other U.S. government agencies has been an added advantage.